2001

Report of the
Auditor General of Canada
to the House of Commons

Matters of Special Importance—2001
Foreword and Main Points

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

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AUDITOR GENERAL OF CANADA

CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my annual Report of 2001 to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(3) of the *Auditor General Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 4 December 2001

Foreword

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Report of the Auditor General of Canada to the House of Commons—2001

Foreword

I am pleased to present my 2001 Report. It contains Matters of Special Importance—2001, Main Points from all the chapters, Appendices, and the following 13 chapters:

Chapter 1	Financial Information Strategy: Infrastructure Readiness
Chapter 2	Recruitment for Canada's Future Public Service: Changing the System
Chapter 3	Recruitment for Canada's Future Public Service: Changing the Practices
Chapter 4	Voted Grants and Contributions: Government-Wide Management
Chapter 5	Voted Grants and Contributions: Program Management
Chapter 6	Atlantic Canada Opportunities Agency—Economic Development
Chapter 7	Canada Customs and Revenue Agency—International Tax Administration: Non-Residents Subject to Canadian Income Tax
Chapter 8	Canada Customs and Revenue Agency—Managing the Risks of Non-Compliance for Commercial Shipments Entering Canada
Chapter 9	Health Canada—A Proactive Approach to Good Health
Chapter 10	National Defence—In-Service Equipment
Chapter 11	Illicit Drugs: The Federal Government's Role
Chapter 12	Follow-Up of Recommendations in Previous Reports
Chapter 13	Other Audit Observations

Matters of Special Importance—2001

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Matters of Special Importance—2001

Main Points

1. This is my first report to the House of Commons as the Auditor General of Canada. In this chapter, I focus on four issues that are of particular concern to me as I assume my new position:

- **The erosion of parliamentary control over how the government raises money and spends it.** Canadians have the right to control how public funds are collected and used, and ultimately it is the members of Parliament we elect who carry out this control on our behalf. That is why I am concerned about recent examples of the erosion of parliamentary control, involving billions of dollars of revenue and expenditure.
- **Strengthening fiscal and financial management.** Over the last five years there has been a significant change in the federal government's fiscal position. The transparency and discipline that have yielded impressive results so far are critical to continued success. Steps have also been taken to improve financial management in departments and agencies. Money must be managed prudently in the interest of the public.
- **The undermanagement of grant and contribution programs.** The recent attention paid to grants and contributions has not yet translated into an overall improvement in the way they are managed across government. Government-wide problems require government-wide solutions.
- **The internal health of the federal public service.** The government has established an ambitious schedule for modernizing human resource management. Good government depends on the performance of the public service. I will be watching these modernization efforts closely.

2. I also comment on some of the key challenges my Office faces. My goal is to ensure that the Office remains a centre of excellence in public sector management, widely respected for the quality of its work.

My First Report

3. I am honoured to submit my first report to the House of Commons as the Auditor General of Canada.

4. Since joining the Office as Deputy Auditor General in 1999, I have benefited tremendously from the wisdom and support of Denis Desautels. He will be remembered as one of Canada's most dedicated and trusted public servants, a man whose integrity was—and is—beyond question.

5. I have also come to know and admire many parliamentarians and many public servants. I continue to be impressed by their knowledge and expertise and their commitment to public service. Many are among the best and brightest men and women I have worked with in my career. The important contributions they make to the social, economic, and political health of this country often go unremarked and unrewarded.

6. The international community recognizes increasingly that governance—how power is exercised, how citizens are given a voice, how decisions are made on issues of public concern—is central to a country's economic and social development. Good governance and development tend to go hand-in-hand.

7. The obligation to account for one's actions is fundamental to making our system work. We grant to government considerable powers to tax and spend and to write and enforce laws. The government is accountable to Parliament for how it uses those powers, and each member of the House of Commons must answer in turn to his or her constituents.

8. The Office of the Auditor General holds a unique place in Canada's parliamentary system. It is independent of government and responsible to Parliament. As Auditor General, my job is to examine the federal government's operations and provide objective information to members of Parliament. They can use that information to hold the government to account for its stewardship of public funds and its delivery of programs and services (Exhibit 1).

9. This chapter focusses on four issues that are of particular concern to me as I assume my new position. These are not new issues; they have figured prominently in previous reports from this Office. But if government is to work better, improvements are clearly needed in these areas:

- The erosion of parliamentary control over how the government raises money and spends it
- The need to strengthen fiscal and financial management in the federal government
- The undermanagement of grant and contribution programs
- The internal health of the federal public service

10. I will also comment on some of the key challenges my Office faces. Many of them mirror the challenges facing the federal government as a whole.

Exhibit 1 What are the Auditor General's responsibilities?

Under the *Auditor General Act*, the Auditor General addresses three main questions:

Is the government presenting its financial information fairly?
This is called "attest" auditing. The auditor attests to, or verifies, that the government's financial statements are a fair presentation of its financial position and results.

Did the government collect or spend the amount of money authorized by Parliament and for the purposes Parliament intended?
This is called "compliance" auditing. The auditor asks if the government has complied with Parliament's wishes.

Were programs run economically and efficiently? Does the government have the means to measure their effectiveness? Was appropriate attention paid to environmental consequences?
This is called "value-for-money" auditing or performance auditing. The auditor asks whether or not taxpayers got value for their tax dollars and whether programs are managed well.

Under the *Financial Administration Act*, the Auditor General asks similar questions about the Crown corporations for which he or she has been appointed auditor.

The erosion of parliamentary control

11. One of my roles as a legislative auditor is to review the federal government's compliance with parliamentary authority. In particular, the government must seek Parliament's approval before it collects and spends money.

12. How the federal government raises money and spends it is rooted in our constitution and in our parliamentary tradition. The underlying principle is a simple one: Canadians have the right to control how public funds are collected and used.

13. Together, Parliament, the government, and public servants are the guardians of the money entrusted to them to deliver programs and services to Canadians. Ultimately, though, it is the members of Parliament we elect who carry out this control on our behalf.

14. That is why I am concerned about the erosion of parliamentary control over how money is raised and spent. Recent reports have cited a number of examples, involving billions of dollars of revenue and expenditure.

Is revenue being raised in a way that is consistent with Parliament's intent?

15. **Employment Insurance premiums.** Employment Insurance is one of the federal government's largest social programs, providing an estimated $12 billion in benefits this year. It provides temporary financial help to unemployed Canadians while they look for work or upgrade their skills, while they are pregnant or caring for a newborn or adopted child, or while they are sick.

16. Employers and workers pay all of the program costs through premiums. Those premiums totalled $18.7 billion for the year ended 31 March 2001, and made up 11 cents of every federal tax dollar.

17. Since 1999, our opinion on the financial statements of the Employment Insurance Account has drawn attention to the Account's balance, the difference between revenues collected and the benefits and administrative costs paid out (Exhibit 2). We have commented on the size of the balance, its rate of growth, and the lack of disclosure of factors that were considered in determining what the premium rate would be.

18. The *Employment Insurance Act* sets out two objectives to guide the setting of premium rates: to ensure that they will generate enough revenue over a business cycle to pay the benefits and costs of the program; and to keep premium rates relatively stable throughout the business cycle. In his 2001 report, the Chief Actuary of Human Resources Development Canada concluded that a balance of 10 to 15 billion dollars should be enough to cover the higher benefit costs associated with a potential recession while preventing premium rates from rising.

19. On 31 March 2001, the balance in the Employment Insurance Account exceeded $36 billion. The Canada Employment Insurance Commission has been unable to provide an adequate rationale for the size and growth of the Account balance. Without that justification, I am unable to conclude whether the premium rates set for 2001 observed the intent of the Act.

20. Recent amendments to the Act override the normal process for setting premium rates while the government reviews the process. Premium rates for 2002 and 2003 will be set at whatever levels Cabinet considers appropriate, based on the recommendation of the ministers of Human Resources Development and Finance.

21. An open and expeditious review of the rate-setting process would go a long way toward enhancing the transparency of the process and ensuring that it clearly complies with the intent of the *Employment Insurance Act*.

Exhibit 2 The Employment Insurance Account

The Employment Insurance Account records the revenues and expenses of the Employment Insurance (EI) program. Amounts received under the *Employment Insurance Act* are deposited to the government's Consolidated Revenue Fund; EI program costs are paid out of that fund. Because the deficit or surplus in the Account is factored into the government's overall fiscal position, any accumulated surplus or deficit is only notional.

The Account's accumulated surplus or deficit should serve as an important factor in setting EI premium rates, because it helps determine the level of premiums needed to keep rates stable over time. Since 1994, however, premium revenue has exceeded program costs, turning that year's accumulated deficit into today's $36 billion surplus.

The EI Account's surplus has a direct impact on the government's fiscal position. The Account, in effect, provides a source of revenue and cash flow for the government and helps reduce its net debt. Without the EI Account, the government's annual surplus would have been $8 billion lower than the $17 billion reported for the year that ended on 31 March 2001.

For additional information, see Observations of the Auditor General on the Financial Statements of the Government of Canada for the Year Ended March 31, 2001.

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Is money being spent without parliamentary approval?

22. Last year, amid growing public and parliamentary concern about the management of grant and contribution programs at Human Resources Development Canada, we identified four principles that should guide public spending (Exhibit 3). The first and minimum requirement was that all government spending should have Parliament's sanction.

23. This report and recent reports provide examples of situations where Parliament was not fully involved before programs were launched (Exhibit 4).

24. **Downsview Park**. Last year we reported that the federal government had established an urban park in Downsview, Ontario at an estimated cost of more than $100 million without the clear and explicit approval of Parliament. Separately, the steps the government took complied with relevant legislation. Together, however, their effect was to leave parliamentary approval out of the decision-making process. This year we reported that a subsequent infusion of roughly $19 million was made to support program activities without formal parliamentary approval.

25. **Canada Foundation for Sustainable Development Technology**. In my observations on the Financial Statements of the Government of Canada, I noted my concern that the government had transferred $50 million to a not-for-profit corporation before Parliament enacted the law that created the Foundation and before it authorized the government to spend the money.

Exhibit 3 Four basic principles of public spending

1. **All government spending should have Parliament's sanction.** Parliamentary control of finances has been described as the bedrock of responsible government. It is based on two central precepts of parliamentary democracy, namely, that the government should not raise money without Parliament's approval, and it should not spend money except for purposes authorized by Parliament. Compliance with parliamentary authority is a minimum requirement that must be met in any disbursement of public funds.
2. **Government spending should be managed with probity and efficiency.** This principle recognizes the fact that public money is money held in trust for the benefit of all Canadians. As a consequence, the government has an obligation to ensure that the money is managed prudently in the interest of the public. It also means the government must try to get maximum value for the dollars it spends.
3. **The value of government spending should be measured by what it achieves.** Historically, the tendency has been to justify government programs more by the resources they used than the results they produced. But governments don't create programs in order to spend money; they establish programs to deliver services that improve the lives of Canadians. That is why they need to be managed for results.
4. **Government spending programs should remain current.** The resources available to government change over time. So do public needs and preferences. To ensure that public spending is allocated to the uses that are valued most, the government needs to evaluate its programs regularly and assess whether they are still relevant, effective, and affordable.

For additional information, see 2000 Report of the Auditor General of Canada, Matters of Special Importance—2000.

26. **Relief for heating expenses.** In this report, I comment on the more than $1.4 billion provided earlier this year to help offset the impact of rising energy prices on home heating costs. The government used financial procedures that enabled it to move quickly. However, by adopting a speedy

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Downsview Park

The 1994 Budget announced the closure of Canadian Forces Base Toronto in Downsview, Ontario, with part of the land to be used for a recreational urban park. In 1997, Canada Lands Company Limited—a Crown corporation—was authorized to set up a subsidiary corporation to develop the park. Downsview Park was incorporated in July 1998 and began operations in April 1999.

Normally when a new Crown corporation is established with unique operating characteristics, it receives a legislative mandate from Parliament. In this case, Downsview Park was set up as a subsidiary even though there are significant differences between its mandate (non-commercial park management) and the primary mandate of the parent corporation (commercial property disposal). An order-in-council was used to incorporate the subsidiary; parliamentary approval was not sought.

When Crown assets such as land are no longer needed, they are normally declared surplus and sold, and the proceeds returned to the Consolidated Revenue Fund. Any program spending from the fund must have parliamentary authority. In the case of Downsview Park, however, assets were transferred directly from National Defence to the subsidiary corporation. The sale of these assets to a private sector company has resulted in the government's indirectly transferring $19 million in cash to Downsview Park to fund new program activities. In our opinion, formal approval by Parliament would have been preferable.

For additional information, see 2001 Report of the Auditor General of Canada, Chapter 13, Other Audit Observations—Parc Downsview Park Inc.

Canada Foundation for Sustainable Development Technology

In February 2000, the government announced its intention to establish a $100 million Sustainable Development Technology Fund to stimulate the development and demonstration of new environmental technologies. Legislation creating a foundation to administer the fund was introduced in the House of Commons in October 2000 but had not been passed when the federal election was called. New legislation was introduced in February 2001 and enacted in June 2001.

Before legislation created the foundation, four Canadian citizens established a not-for-profit corporation called the Foundation for Sustainable Development Technology in Canada. The government signed a funding agreement with that foundation in March 2001 and provided it with $50 million in April 2001. Parliament will be asked to approve this funding retroactively when it votes on the Estimates.

For additional information, see Observations of the Auditor General on the Financial Statements of the Government of Canada for the Year Ended March 31, 2001.

Relief for heating expenses

In response to the impact of rising energy prices on home heating costs, in October 2000 the government announced the Relief for Heating Expenses initiative. It proposed to amend the *Income Tax Act* to obtain parliamentary authority for the payments. In January 2001, a one-time payment of $125 to each low- and modest-income individual eligible for the goods and services tax credit and $250 to each eligible low- and modest-income family was provided at a total cost of over $1.4 billion.

On 22 October 2000, Parliament was dissolved for the general election. Legislation to authorize the payments had not been introduced before Parliament was dissolved. As a result, Parliament was not asked to approve the expenditure before the payments were made.

Instead of following the normal parliamentary process of introducing or amending legislation, the government used an order-in-council when the House of Commons was not in session to authorize ex gratia payments; two special warrants were issued to appropriate the funds.

An ex gratia payment is normally made to resolve claims against the government arising from its operations, such as compensation for damage to an employee's clothing or personal effects while at work. It is a benevolent payment made under the authority of the Governor in Council, and made only when there is no statutory, regulatory, or policy vehicle to make the payment.

Special warrants are used to obtain funds to support the government's ongoing operations when Parliament is dissolved during an election period. They are normally used when there is an urgent need for funds, and no other source is available. The special warrants were reported to Parliament on 12 February 2001.

For additional information, see 2001 Report of the Auditor General of Canada, Chapter 13, Other Audit Observations—Department of Finance—Parliamentary oversight weakened in poorly targeted relief for heating expenses.

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Are new forms of delivery putting parliamentary oversight at risk?

27. Government programs and services traditionally have been delivered to Canadians by departments, agencies, and Crown corporations that report directly to ministers and are subject to ministerial accountability (Exhibit 5). This is still how most federal programs and services are provided.

28. During the last decade, however, the federal government has encouraged departments to develop new and potentially more efficient ways of delivering services to Canadians. In some cases, rather than delivering programs or providing services itself, the federal government shares delivery

Exhibit 5 Federal approaches to program and service delivery arrangements

Arrangement	Key features	Examples
Traditional ministerial accountability arrangements		
Departments and agencies	Federal entities reporting directly to a minister and subject to the administrative rules and regulations of the Treasury Board and the Public Service Commission	Transport Canada Statistics Canada Immigration and Refugee Board of Canada
Crown corporations	Federal entities that have a board of directors, are involved in a federal public policy purpose, and report through a minister to Parliament	Export Development Corporation Canada Post Corporation Canadian Broadcasting Corporation
New arrangements under direct ministerial accountability		
Special operating agency	Remains part of a federal department, reporting to a deputy minister	Passport Office
Service agency	A federal entity with its own chief executive officer reporting to a minister but with greater administrative autonomy than a department	Canadian Food Inspection Agency Parks Canada Canada Customs and Revenue Agency
New governance arrangements		
Collaborative arrangements	Partnering arrangements with other levels of government and the private and/or the voluntary sectors, where policy and operational decision making and risk are shared among partners	Labour market development agreements Canada's Model Forest Program
Delegated arrangements	Arrangements where the federal government confers discretionary authority and responsibility for program design, planning, management, and delivery of federal functions to independent outside bodies, usually corporate boards of directors, within a broad strategic policy framework provided by the government	Canada Foundation for Innovation Canadian Television Fund The St. Lawrence Seaway Management Corporation

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Delegated arrangements	Arrangements where the federal government confers discretionary authority and responsibility for program design, planning, management, and delivery of federal functions to independent outside bodies, usually corporate boards of directors, within a broad strategic policy framework provided by the government	Canada Foundation for Innovation Canadian Television Fund The St. Lawrence Seaway Management Corporation

with other parties or delegates to them key planning and operational decisions. In these cases, the federal government becomes a partner rather than a provider.

29. In 1999 we reported that the federal government had entered into more than 75 of these arrangements, involving expenditures that totalled over $5 billion each year. By their very nature, these arrangements challenge the tradition of ministers answering to Parliament for policies and programs and, through Parliament, to Canadian taxpayers. Accountability becomes more complex.

30. Regardless of who delivers the programs and services, however, Canadians expect the delivery to be impartial, fair, equitable, prudent, honest, and professional. They also expect that Parliament can examine how tax dollars are spent and whether the public policy purposes are achieved.

31. Many of these new arrangements lack a structure for accountability that allows for effective oversight by Parliament. Next year we will follow up on our earlier work on this and related issues.

32. There is a balance to be struck between the independence and flexibility these arrangements need to operate efficiently and the need for adequate accountability. I believe that appropriate accountability to Parliament and the public—including audit—can coexist with independence from government intervention in day-to-day operations.

Strengthening fiscal and financial management

Making progress

33. When the two previous Auditors General were appointed, the federal government's debt was high and rising as a share of Canada's total production of goods and services. Interest payments were consuming a growing share of revenue.

34. Over the last five years, however, the federal government's fiscal position has changed significantly (Exhibit 6):

- There have been four consecutive annual surpluses, beginning in 1997–98. These were the first surpluses recorded in almost 30 years.
- These surpluses, coupled with growth in the economy, have lowered the ratio of net debt to gross domestic product by close to 20 percentage points from its peak in 1995–96. The ratio is at its lowest level since the mid-1980s.
- With declining interest rates and increasing revenues, the portion of tax revenue going to debt service charges has fallen by a third.

35. The Budget is the single most important vehicle for reconciling a government's policy priorities and putting them into effect. It represents the government's fiscal response to current and foreseen economic and social conditions.

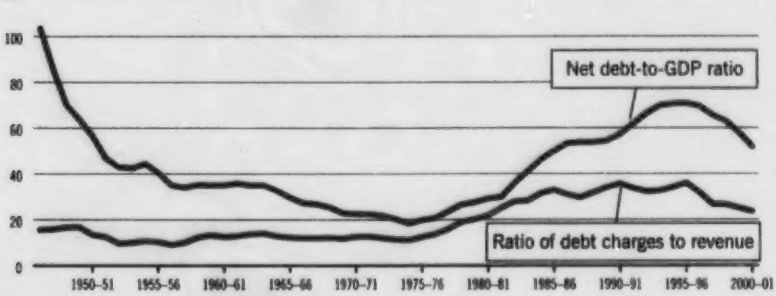
36. To achieve its fiscal results, the government has made a number of changes to the Budget process:

- Fall economic and fiscal updates, combined with pre-Budget hearings by the House of Commons Standing Committee on Finance, have become regular parts of the Budget process, making it more open and transparent. They receive a great deal of publicity and help inform Canadians about the constraints the federal government faces and the trade-offs it needs to make.
- The government uses private sector economic forecasts in planning the Budget and developing detailed projections of revenues and expenditures. It assumes that the consensus forecast is more accurate than a forecast by a single government source.
- Fiscal projections incorporate a "prudence factor" to cover the risk of errors in forecasting: interest rates are assumed to be higher and economic growth is assumed to be lower than the private sector consensus. A contingency reserve is also included to enable the government to respond to unforeseen events.

37. The federal government has also taken steps to strengthen financial management in departments and agencies. Its challenge now is to make the new tools work for managers and not just for financial specialists. In time, they will bear fruit.

- Through its Financial Information Strategy, the federal government is moving toward new, modern accounting methods and systems that will give managers better and more timely information on the costs of their activities. This long-awaited strategy has made a great deal of progress in the last year, but much remains to be done before it can be considered complete.
- The Modern Comptrollership initiative is designed to improve management practices and the stewardship of public resources. The goal is to integrate financial with non-financial performance information for managers and provide a sound approach to risk management, appropriate control systems, and a shared set of values and ethics. Next year we will report the results of our first audit of this initiative.

Exhibit 6 The federal government's fiscal position



Source: Department of Finance

38. It took a long time for the federal government's fiscal position to erode—today's debt is the accumulation of many years of deficits—and it will take a long time to restore it to health. The transparency and discipline that have yielded impressive results so far are critical to continued success. Money must be managed prudently in the interests of the public. We note the following:

- The federal government's debt is still equivalent to more than half of Canada's total annual production of goods and services. This is high, by both international and historical standards.
- One in four tax dollars pays for programs and services of past governments and is not available for today's needs, whether for lowering taxes, funding new programs and services, or reducing the debt.
- The economy is weakening at the same time as pressures are growing for a range of new expenditures.

Paying attention to the longer term

39. I believe that the Budget process needs to be more forward-looking. Beginning with the *1999 Economic and Fiscal Update*, the government moved from a two-year to a five-year presentation of revenues and expenditures to allow public debate of policy options. However, Budget decisions are still made within a two-year planning horizon.

40. While the government has taken a step in the right direction, today's decisions do have longer-term consequences that it needs to take into account. The aging of Canada's population, for example, can affect government finances in a significant way.

41. Other countries are providing long-term budget projections to help their legislatures and the public make more informed choices about current and new programs and about how to share the costs between present and future generations.

42. The federal government has presented this type of information in the past for some program areas, such as the Canada Pension Plan. But it has not provided an overall picture of its own long-term fiscal health.

43. Long-term fiscal projections are subject to a greater risk of error than short-term projections, and thus need to be used with care. In some jurisdictions, they are clearly labelled "illustrative." Nevertheless, it is better to have some information on which to base current decisions than to have none at all.

The "year-end scramble"

44. Fifteen years ago, this Office audited year-end spending of surplus funds. Departments and agencies receive authority from Parliament to spend money for specific purposes. This authority normally expires at the end of the fiscal year for which it was approved.

45. We were concerned about the incentive this provided for departments to go on a year-end spending spree to avoid lapsing funds. As a result, they paid less attention to ensuring that they got value for the money they spent.

46. We were particularly concerned about the extra costs to the taxpayer of making purchases in advance of need and making payments before they were due. It costs money to spend early, mainly in the form of more interest paid than is necessary.

47. Since 1993, departments have been allowed to carry forward part of their budgets from one year to the next, reducing the incentive to spend at year-end. But as the former Auditor General noted, the year-end spending spree by individual departments has been replaced by a similar practice at the aggregate level.

48. We see the government announcing large amounts of new spending close to the year-end. In these circumstances, we need to ask whether decisions to spend are based on when to record expenditures rather than on how to best use taxpayers' dollars.

Transfers to foundations

49. My report on the 2000–01 Financial Statements of the Government of Canada provides an example. I noted my concern about the government's practice of creating various foundations to achieve its policy objectives and then transferring significant amounts of public money to them long before they actually pay the money to the intended recipients.

50. Since 1997, the government has created a number of new organizations to support, for example, research and development, students in post-secondary education, and Aboriginal healing (Exhibit 7). It has allocated more than $7 billion to nine of these foundations and recorded that amount as spending by the federal government. Most of those funds, however, are still in the foundations' bank accounts and investments.

51. While the foundations will support worthy causes, I am concerned that a prime motivator for funding them in advance is the accounting impact on the government's bottom line: showing larger expenditures today and smaller ones tomorrow reduces the size of current surpluses. I am also concerned that Parliament has only limited means of holding the government to account for the public policy functions performed by these foundations.

52. There are many ways for the government to pursue its policy objectives. It has not yet assessed the appropriateness, the cost, or the effectiveness of this particular vehicle. I think it should.

The undermanagement of grant and contribution programs

53. Through grant and contribution programs, the federal government transfers large amounts of money to individuals and to organizations of various types, including volunteers, not-for-profit groups, businesses, and other governments. Just under two thirds of these transfers are statutory—Old Age Security, for instance—and thus do not require Parliament's approval each year. But $15 billion comprises payments that are more discretionary and do require an annual vote of funds by Parliament.

54. In 1998, we reported that two decades of audits of grant and contribution programs had sent a consistent message: there are serious and chronic problems in the way they are managed. A lack of diligence in

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designing programs, assessing project applications, and monitoring recipients' performance meant that public funds were placed at risk.

55. Our most recent audits demonstrated that good management is achievable, if not always achieved. Some aspects of programs we have looked at are managed well. Other programs have been improved in response to specific recommendations we and parliamentary committees have made. And the Treasury Board Secretariat recently released a revised and improved policy framework for managing these types of programs.

56. But the attention paid to grants and contributions has not yet been translated into overall improvement in the way they are managed across the federal government. As this report shows, all programs we audited had one or more significant shortcomings.

57. Many program officers and managers of grants and contributions think they have not been trained adequately to do their jobs. Many believe they lack the time to assess projects properly before recommending them for funding and to monitor them once they are approved.

58. Government-wide problems require government-wide solutions. Departments can do a better job of training staff and making sure they have the capacity to carry out their responsibilities. The Treasury Board and its Secretariat can do more to meet their responsibilities for managing government-wide, providing guidance to departments in support of the new policies, and monitoring departments' performance.

Exhibit 7 Summary financial information on the foundations, 1997–98 to 2000–01 ($ millions)

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Canada Foundation for Innovation	1997	3,150	325	230	14	3,041
Aboriginal Healing Foundation	1998	350	56	49	19	324
Canada Millennium Scholarship Foundation	1998	2,500	282	292	16	2,493
Canadian Foundation for Climate and Atmospheric Sciences	2000	60	0	3	1	62
Genome Canada	2000	300	2	10	2	306
Green Municipal Enabling Fund	2000	25	1	2	0	26
Green Municipal Investment Fund	2000	100	0	7	2	105
Canada Foundation for Sustainable Development Technology	2000	100	0	0	0	100
Canada Health Infoway Inc.	2000	500	0	0	0	500
	Total	7,085	666	593	54	6,957

Note: Information is based on the latest annual report, where 31 March 2001 financial statements were not available. Funding received includes accounts payable by the federal government.

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59. The government has committed to evaluating all grant and contribution programs by 31 March 2005, and to establishing new terms and conditions for them. The results of those evaluations should be reported to Parliament program by program, so that parliamentarians can judge whether value for money is being obtained.

The internal health of the public service

60. Public servants help ministers to serve the common good. They provide policy advice—analyzing issues, identifying options, and making recommendations. They deliver a wide range of services, from weather reports to food inspection. And they manage and administer a large number of programs and organizations.

61. The federal government is Canada's largest single employer. Perhaps more than other professions, the public service has been going through a long and often difficult period of renewal, seeking to do more with less, to focus on results, and to improve service to Canadians.

62. Both of my predecessors ended their terms with calls for major changes if Canada's public service is to remain among the best in the world. Both also commented on the long history of efforts to reform and renew the public service.

63. Those efforts produced few lasting results. Yet, at the same time, the human resource challenges have grown more urgent—poor labour-management relations, an impending "retirement bulge," and increasing competition from other employers for "knowledge workers."

64. The government has established an ambitious schedule for modernizing human resource management in the public service. The necessary legislative amendments will be introduced in Parliament before the summer of 2002. In the interim, the government is exploring changes in processes, policies, and systems that would not require legislative action.

65. Good government depends on the performance of the public service. I will be watching these modernization efforts closely.

A centre of excellence

The challenges my Office faces

66. Like my predecessors, I am committed to making a difference by helping Parliament be as effective as possible in exercising its powers of oversight.

67. An independent Auditor General has played this role since 1878. But legislative audit has itself progressed, from looking at individual financial transactions to ensure that the rules were followed to reporting on the management of entire programs that spend billions of dollars. Many of these programs involve multiple departments and multiple jurisdictions.

68. My predecessors ensured that the Office adapted well to changing expectations of what an audit office can and should do. They recognized that our single most important asset is the combined talent and knowledge of the people who work here. The credibility and the stature of the Office flow directly from their creativity, their professionalism, and their dedication.

69. Looking ahead, the challenges my Office faces mirror those of the government as a whole—the need for the right people, working in the right environment, with the right tools. We are responding with a significant reinvestment in the infrastructure of the Office: our human capital and our audit methodology and tools.

70. A large part of our staff is nearing retirement; we must ensure continuity in our management and in our audit capacity. And recent developments—such as the introduction of the modern comptrollership initiative, new financial information systems, and new audit methodologies in the public and private sectors—mean that we must adapt and fine-tune our audit approach.

71. My goal is to ensure that the Office remains a centre of excellence in public sector management, widely respected for the quality of its work.

A Final Note

72. Halfway through his mandate as Auditor General, Denis Desautels commented on the loss of public confidence in governments. Some analysts had concluded that this loss of confidence represented one of the most significant changes in public attitudes in recent years.

73. An important part of people's confidence in our democratic institutions is the belief that public funds are spent wisely. By its nature, auditing uncovers problems. But the objective is to identify ways to improve the economy, efficiency, effectiveness, and environmental performance of the federal government—in short, to help make government work better. My reports will be pointed, but also balanced and constructive.

74. Good government is important for all Canadians. Some of the most pressing issues the government must manage—the economy, health care, the environment, security, the relationship with First Nations—affect not only our here and now but also our legacy to our children. I will do my best to help ensure that our legacy is a positive one.

Main Points

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Main Points

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Financial Information Strategy
Infrastructure Readiness

Chapter 1 Main Points

1.1 The government has made a lot of progress in the last year toward getting its long-awaited Financial Information Strategy (FIS) up and running. However, it still has a lot to do before FIS can be considered complete.

1.2 Departments and agencies have installed new financial systems that can handle the accrual accounting requirements of FIS. They have created the needed interfaces to transmit summary financial information to the FIS central systems. Now, though, departments need to stabilize these new systems, ensure that appropriate controls are in place, and provide complete, accurate financial information that managers will use.

1.3 The Treasury Board Secretariat has developed and communicated the accounting policies that will move the government to a full accrual basis of accounting, in accordance with generally accepted accounting principles for the public sector. Departments are at different stages of applying these policies and determining their opening balances for such items as tangible capital assets. The government and departments are to produce their first set of accrual-based financial statements for the year ending 31 March 2002. The current reporting model for departments does not require them, however, to record and disclose in their financial statements some significant liabilities and costs.

1.4 The government recognizes the significant change it will have to manage. Departments have change management plans at various stages of implementation. The plans include developing management reporting and training managers to use the new financial tools available to them. These plans are essential to realizing the full benefits of FIS.

1.5 The government has not progressed much toward deciding its approach to accrual-based budgeting and appropriations. Responding to a request by the Standing Committee on Public Accounts, the Secretariat said this complex issue requires extensive study before a decision is made. The government called the Committee's suggested April 2003 target date for the introduction of accrual budgeting and appropriations highly unlikely. But departments have said clearly that the change in culture demanded by accrual accounting will not happen without accrual budgeting and appropriations. We agree. Departments are worried about the added complexity during the interval when they will have to prepare the information in their Estimates on a different basis from the information in their financial statements.

1.6 In response to another request by the Standing Committee on Public Accounts, the government surveyed departments to obtain an estimate of FIS costs across government. The survey results indicated that the total cost would ultimately be around $635 million. We cannot conclude whether this estimate is reasonable because the government did not establish a framework for reporting FIS costs and ensuring that the figures were complete and accurate.

1.7 As FIS funding dries up and FIS project offices are wound down, there is a real concern that the momentum to finish the job may be lost. The government should not lose sight of its key objectives for FIS and the results it expects, such as better financial information for managers. It also needs to ensure that both it and departments produce their accrual financial statements. Then it can reassess the status of the strategy's other aspects and decide how best to ensure that they are completed.

Background and other observations

1.8 The government officially launched its Financial Information Strategy (FIS) in 1989 and, after several false starts, revitalized the project in 1995. It set April 2001 as the target for having the strategy in place across departments.

1.9 FIS is a prerequisite to the success of two other federal initiatives: Modern Comptrollership and Results for Canadians: A Management Framework for the Government of Canada. It supports three of the four key elements of modern comptrollership, and the information it provides is fundamental in linking costs to results. Our Office is currently auditing departmental plans and strategies for Modern Comptrollership and will report the results in April 2002.

1.10 In 1995, the government set several objectives for FIS: implement modern financial systems in departments and agencies, develop new central systems, introduce accrual accounting policies, and provide managers with better financial information for day-to-day decision making. Our Office supports these objectives fully.

1.11 The Standing Committee on Public Accounts continues to demonstrate strong support for FIS. The Committee recently issued two reports urging the Treasury Board Secretariat to act, particularly on the issue of accrual-based budgeting and appropriations.

The Treasury Board Secretariat has responded. The Secretariat has agreed with our recommendations and its responses to them in the chapter describe current or planned action to address them.

Recruiting for Canada's Future Public Service

Changing the System

Chapter 2

Main Points

2.1 The legislative and management framework for public service recruitment requires radical change to ensure that new systems and practices will be more responsive to both the operational requirements of departments and the long-term needs of the public service.

2.2 Our review of public service recruitment found that an alternative system of short-term hiring has emerged as the main hiring practice. We found that flaws in the system prompt managers to work around what they view as an overwhelmingly cumbersome process. Systemic problems are further complicated by weaknesses in human resource planning, workload and funding pressures, and the need for improved recruitment tools, outlined in Chapter 3. These system- and practice-related problems have combined to create a culture of short-term hiring that will have significant long-term repercussions on the public service.

2.3 These issues have been studied for years. But the changes made so far have been an inadequate response to identified deficiencies and to recommendations for resolving them. The government plans to introduce legislation in 2002 to modernize the human resource management regime. We strongly support this initiative and urge the government to take quick and decisive action to meet the significant challenges it faces.

Background and other observations

2.4 The public services faces a significant "human capital" challenge—the need for enough skilled people to perform its work, given the demographic profile of the public service; a shift in the nature of work; an increasingly tight market for talent; and negative perceptions of the public service as a career choice. To address this challenge, the Clerk of the Privy Council has identified recruitment as one of three human resource priorities across the public service.

2.5 This audit examined recruitment: the actions taken by central agencies and hiring managers to ensure that the public service is hiring enough skilled people to perform its work. We looked at six departments; we focussed on recruiting in the Scientific and Professional category and the Administrative and Foreign Service category, which are the key sources of people to replace the Executive leadership group. The Executive group could experience a 70 percent loss through retirements by 2008.

2.6 We are reporting the audit in two chapters. Reading both is essential to a full understanding of the issues involved and their interrelationships. This chapter identifies problems in the recruitment and staffing system and discusses the need for legislative changes. Chapter 3 focusses on improvements that do not require legislative change: how managers and departments identify their recruiting needs; how they fill them; and what support hiring managers receive from their departments and from central agencies.

2.7 We believe that both in departments and in the broader public service, experience with fully delegated staffing demonstrates a potential for greater decentralization that should be considered in a new legislative model.

2.8 In our opinion, with three different central agencies providing reports to Parliament on different aspects of human resource management, it is difficult for parliamentarians to get a clear picture of the risks, the challenges, and the state of human resource management—conditions that could affect the outcomes of services to Canadians.

The government has responded. The response of the Privy Council Office, on behalf of the government and the departments we audited, and the response of the Public Service Commission are included at the end of Chapter 3. The government's response supports the need for legislative change. The responses recognize the need to address our audit observations and the recommendations for improving recruitment practices that we have made in Chapter 3.

Recruiting for Canada's Future Public Service

Changing the Practices

Chapter 3

Main Points

3.1 Our review of public service recruitment identified a culture of short-term hiring. Due to workload pressures, departments often fill vacancies with casual and term employees instead of hiring indeterminate staff. These actions are driven by the delays and problems associated with the existing recruitment and staffing system and by inadequate human resource planning and recruitment practices.

3.2 We found weaknesses in some key areas:

- The absence of comprehensive human resource planning that is integrated with operational business plans means that senior management does not have the information it needs to develop recruitment strategies. Senior management lacks information to identify the funding needed to support recruitment, and hiring managers do not focus on the broader long-term needs of the organization.
- Hiring managers need more central and departmental inventories of pre-qualified individuals that they can draw from quickly to meet their recruitment needs.
- The government needs to upgrade its Internet-based electronic recruitment system to provide better service both to applicants and to the managers who need staff.
- Improvements need to be made in the analysis of recruitment-related information and in reporting to senior management on issues, opportunities, risks, and threats.

3.3 A more global view of human resource management is needed to break the cycle of meeting recruitment needs one job at a time and to ensure that actions will be taken to meet present and emerging needs. Hiring managers need to look beyond the short-term filling of vacancies to ensure that recruitment they undertake will meet both immediate and long-term operational needs.

3.4 Human resource advisors need to change their focus from rules-based control of the process to working with line managers using a more strategic and service-oriented approach.

Background and other observations

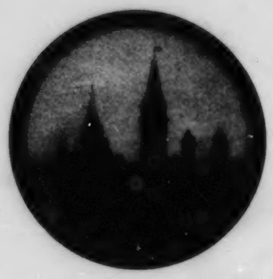
3.5 This audit examined recruitment: the actions taken by central agencies and hiring managers to ensure that the public service will have enough skilled people to perform its work. We looked at six departments; we focussed on recruiting to the Scientific and Professional category and the Administrative and Foreign Service category.

3.6 The audit is reported in two chapters. Chapter 2 focusses on problems in the recruitment and staffing system and the need for legislative change. In this chapter we focus on improvements that do not require legislative change. We look at how managers and departments identify their recruiting needs, how they fill them, and what support hiring managers receive from their departments and central agencies.

3.7 The public service already faces hiring challenges and shortages in almost half the occupational groups we reviewed. The situation will worsen due to changing demographics, anticipated retirements, shifts in the nature of work, and competition from both the private and the public sector for candidates.

3.8 The public service of the 21st century needs effective recruitment tools and support that respond quickly and efficiently to its needs. If it continues to take months to fill vacancies, good candidates will accept work elsewhere. Concentrated effort will be needed by all parties concerned to attract and retain the candidates the government needs in an increasingly tight labour market.

The government has responded. The response of the Privy Council Office, on behalf of the government and the departments we audited, and the response of the Public Service Commission are included at the end of this chapter. The responses recognize the need to address our audit observations and the recommendations we have made for improving recruitment practices.



Voted Grants and Contributions
Government-Wide Management

Chapter 4

Main Points

4.1 The government still has a lot to do to fix the chronic problems in the way it manages grants and contributions. Our most recent audits found a government-wide control system for grants and contributions that is not yet rigorous enough to ensure the proper management of public funds. We are concerned that serious and correctable problems remain unexamined and uncorrected.

4.2 The Treasury Board Secretariat does not yet monitor departmental operations adequately, and departments often fail to exercise minimum control. Grant and contribution programs tend to be undermanaged—departments pay too little attention to their design, delivery, capacity, and performance and to the training of staff who manage them. Until the Secretariat and departments meet all of their responsibilities and manage grants and contributions rigorously, these programs will have chronic problems and run an ongoing risk of using public funds ineffectively and inefficiently.

4.3 Management practices were uneven among the programs we audited. Most programs had significant shortcomings in one area or more—program design, performance measurement, project approval, or project monitoring. In other programs, we found that departments were fixing, or had fixed, problems we reported in 1999 and 2000—indicating to us that good management is achievable, if not always achieved. The problems we found were not on the scale of those in Human Resources Development Canada (HRDC) that we reported in 2000. But they were similar to what we had found in previous years in many other grant and contribution programs.

4.4 Over the past year and a half, the Treasury Board and its Secretariat took many important steps to improve the management of grants and contributions government-wide, in particular, setting out a new and better policy framework. Five new or revised policies will impact on grants and contributions. While a good foundation is now in place, it will take several years to bring all grant and contribution programs up to the standard of the revised policy framework.

4.5 We surveyed program officers and managers in nine of the programs we audited. Many said they did not feel adequately trained to do their jobs. Many believed that they lacked the time both to assess projects properly before they recommended funding and to monitor the projects that were funded. At the same time, most were satisfied with key aspects of the design of their programs.

4.6 With its revised Policy on Transfer Payments, the government is committed to evaluating all its grant and contribution programs and approving new or revised terms and conditions before 31 March 2005. This is an opportunity for the government to determine whether each grant and contribution program is achieving value for money and should continue or whether it should be modified or even terminated.

Background and other observations

4.7 The federal government plans to spend roughly $16.3 billion through voted grants and contributions in 2001–02, and another $27.4 billion through statutory grants and contributions. Over the past year, we carried out a series of audits to answer three questions:

- Are departments managing well the voted grant and contribution programs we audited?
- Are the Treasury Board and the Treasury Board Secretariat carrying out their responsibilities for setting government policy on the management of grants and contributions and for monitoring the performance of departments?
- What are the causes of government-wide problems in the management of grants and contributions?

The programs we audited plan to spend about $1.3 billion in 2001–02. (That amount does not include planned spending by the programs our follow-up work considered.)

4.8 In 1999 the Standing Committee on Public Accounts tabled its Twenty-Fourth Report to the House of Commons, which covered our December 1998 Report, Chapter 27, Grants and Contributions: Selected Programs in Industry Canada and Canadian Heritage. The Committee recommended that this Office undertake a comprehensive audit of the management of grant and contribution programs and report our conclusions and recommendations to Parliament. The audits we are reporting this year respond to that recommendation.

The Treasury Board Secretariat has responded. The Secretariat agrees with our recommendations. Actions and plans it has under way are indicated in its response at the end of the chapter.

Voted Grants and Contributions
Program Management

Chapter 5

Main Points

5.1 We carried out audits of a number of grant and contribution programs in several departments and agencies over the past year. We found that management practices were uneven among these programs. While audit results varied to some extent, all the programs were experiencing problems in one or more areas of management responsibility—program design, performance measurement, project assessment, and project monitoring.

Program management issues

- Program design needs attention in most programs, in particular, the specific results expected from the spending of public money.
- Management has not yet developed risk management strategies to help deliver programs in a cost-effective way.
- Where they have been carried out, program evaluations are often limited in scope and do not provide a clear overview of whether the programs are achieving value for money.
- Many programs have not been audited in more than five years.
- Parliament, despite changes to the reporting requirements, still receives limited information on program performance.

Project management issues

- Decisions to fund projects are often based on partial or perfunctory assessments of project merits and the need for government funding.
- Financial control over disbursements of public funds was generally satisfactory, although specific improvements are needed in some programs.
- Project monitoring practices ranged from satisfactory in some programs to poor in others.

5.2 We followed up on three audits of grant and contribution programs we had reported previously, including our work in Human Resources Development Canada in 2000. By and large, management has made satisfactory progress in fixing the problems we had found—indicating that good management is achievable, if not always achieved.

Background

5.3 In this chapter, we report the results of our audits of 12 grant and contribution programs in nine departments and agencies and our follow-up of three audits previously reported. We looked for key control elements—rigorous program design, relevant performance measurement and reporting, thorough project assessments, and appropriate project monitoring and financial management.

The departments have responded. The departments we audited have indicated their agreement with our recommendations. The actions they have taken or plan to take are set out in their responses to the recommendations in the respective sections of the chapter.

Atlantic Canada Opportunities Agency

Economic Development

Chapter 6

Main Points

6.1 We found that the Agency has used due diligence in approving, assessing, and monitoring commercial projects and in managing its portfolio of repayable contributions. The Agency's assessment of commercial projects has become more rigorous since our last audit in 1995. However, it has not reported publicly on its performance in managing $400 million of repayable contributions.

6.2 The objectives and expected results of non-commercial projects and federal-provincial agreements are often stated vaguely. In the absence of clear, concrete expected results, it is difficult to determine the rate of progress and the success of these projects.

6.3 Increasingly, the Agency uses partnerships and alliances with other levels of government and not-for-profit organizations to fulfil its mandate for economic development. But it does not have a consistent overall approach to managing these partnerships. Nor has it evaluated the cost effectiveness of partnerships and alliances as a means of delivering its programs.

6.4 Management controls over practices common to both commercial and non-commercial projects were satisfactory, except for the following:

- The Agency has not developed a strategy to implement its policy against providing core funding beyond three years to not-for-profit organizations.
- Its letters of offer to recipients of funding did not include some key provisions required by the Treasury Board and designed to protect the government's interest.
- Potential environmental impacts were not considered as an integral part of decisions to approve projects.

6.5 The Agency reports a great deal of performance information publicly, most of it supported by reasonable evidence. It has established specific results it expects for many objectives. However, the accuracy and relevance of the employment impact it has reported for non-commercial projects are questionable.

Background and other observations

6.6 The Atlantic Canada Opportunities Agency (ACOA) provides financial support to a wide variety of projects. Commercial projects are intended to help businesses increase profits or expand. Assistance for non-commercial projects generally goes to other levels of government or to not-for-profit organizations for projects intended to assist "enabling" projects that have a long-term or indirect impact.

6.7 ACOA is the federal government's lead agency for co-ordinating and carrying out activities to support economic development in Atlantic Canada. It works with a variety of organizations, including federal departments, provincial governments, not-for-profit organizations, and businesses.

6.8 ACOA spent $283 million in 2000–01, $266.6 million of it on its development business line. The programs in this business line have a range of objectives, provide different types of financial assistance, and are delivered by a variety of methods.

The Agency has responded. The Atlantic Canada Opportunities Agency's responses to our recommendations are included in this chapter. The Agency agrees with the recommendations and indicates the actions that it is taking or intends to take to address them.

Canada Customs and Revenue Agency

International Tax Administration: Non-Residents Subject to Canadian Income Tax

Chapter 7 Main Points

7.1 The Canada Customs and Revenue Agency reports that in 2000–01 about $3 billion in tax was paid by over 1.7 million non-residents who earn income from Canadian employment, contract services, investments, pensions, and other sources taxable in Canada. The Agency's non-resident enforcement activities have added an additional $350 million in tax.

7.2 The Agency provides a range of services to help non-residents meet their income tax obligations: responding to inquiries; issuing waivers, which reduce the tax withheld on payments to non-residents; and establishing three film industry services units to better service the film and television industry. It also plans to increase its on-line services.

7.3 Many divisions of the Compliance Programs Branch carry out activities to verify compliance with the non-resident tax regime, but they are not guided by a formal risk assessment or a comprehensive compliance strategy to address non-resident tax risk.

7.4 There are gaps in non-resident enforcement: verification of capital gains tax owed by emigrants is inadequate, and high-income non-residents have not been required to file tax returns and pay all taxes owing.

7.5 When reviewing the tax consequences of the sale of Canadian property by non-residents, the Agency has improved its challenging of complex transactions undertaken by non-resident corporations to reorganize their Canadian assets and has identified additional current and future taxes.

Background and other observations

7.6 In some respects, electronic capture and matching programs and automatic compliance routines for non-resident data lag behind domestic tax data.

7.7 The Canada–Barbados Income Tax Agreement is providing opportunities for aggressive tax planning that challenge the Agency's enforcement capability and may cause significant unintended reductions to the tax base.

The Agency has responded. The Canada Customs and Revenue Agency's responses to our recommendations are included in the chapter. The Agency agrees with the 10 recommendations, and its responses describe a number of actions under way to deal with them.

Canada Customs and Revenue Agency

Managing the Risks of Non-Compliance for Commercial Shipments Entering Canada

Chapter 8

Main Points

8.1 The Canada Customs and Revenue Agency (CCRA) needs to improve its enforcement activities for commercial shipments, both how it identifies high-risk shipments and how it analyzes the results of its activities. While it has worked hard over the past decade to improve its enforcement activities, it still faces many challenges. The Agency is using a risk management approach to determine which shipments present the greatest risk to Canadian society so it can focus on those shipments and let the others pass through quickly.

8.2 The Agency has tried to improve its compliance verification activities by implementing a new approach to ensuring that importers are complying with Customs trade laws and regulations. However, after six years and a lot of effort, it has made little headway in assessing how well importers are following the rules. A revised approach is promising but has yet to be proved.

8.3 The CCRA has made it easier for importers to bring legitimate goods into Canada and has provided them with several processing options. Importers who are pre-approved and those who send the required information to the Agency before the shipment arrives at the border experience little delay of their shipments.

Background and other observations

8.4 As a trading nation, the health of Canada's economy depends on imports and exports. In the past eight years, the volume of commercial shipments entering Canada has increased dramatically, from 7 million a year to over 10 million today. The increase in volume is partly because of the North American Free Trade Agreement.

8.5 The objective of the Customs program is to protect Canadian society and promote Canada's competitiveness. Until this year, the Agency has not provided Parliament with enough information to show how well it is achieving these objectives. The new performance report required by the Agency's legislation provides more information, but the Agency still needs to develop detailed performance measures, set expectations, and evaluate actual performance against expectations.

8.6 The Customs Action Plan is the CCRA's plan to change the Customs program in the near future. In our view, it includes many good ideas to help the CCRA achieve its objectives. We are concerned, however, that the Agency is going ahead with the Customs Self Assessment initiative before its compliance verification regime is solidly established.

The Agency has responded. The Agency agrees with our recommendations and in its responses has indicated the actions it will take to address them.

Health Canada

A Proactive Approach to Good Health

Chapter 9

Main Points

9.1 We looked at how well population health projects were managed in three programs of Health Canada's Population and Public Health Branch. We found inconsistent management practices.

- The projects in the Canada Prenatal Nutrition Program were generally well managed.
- Many projects in the HIV/AIDS strategy were poorly managed, regardless of the dollar amount funded. For example, projects were approved despite concerns identified in the selection process, and the Branch failed to take timely action to remedy identified problems.
- Six large national projects in the Population Health Fund suffered from specific and significant problems. In particular, management did not have the proper authority to fund projects for prostate cancer research and enhanced fitness activities. Further, these projects were not subjected to the required selection process.

9.2 Choosing the "right" priorities at the outset is a critical step toward committing resources to areas that will yield the most benefit in improved population health. The Population and Public Health Branch has developed a framework or process for setting its priorities. However, the framework has never been approved and there is no plan or timetable for implementing it.

9.3 The evaluation of population health programs is generally weak. We found that the Department had made little progress in developing performance indicators for most programs. Such indicators are central to any meaningful evaluation exercise. Objective information on the effectiveness of the three programs that we looked at was limited. The information that Parliament receives on these programs does not provide a clear picture of the extent to which the $225 million spent on the programs has improved the health of Canadians.

Background and other observations

9.4 The federal government provides leadership and support for preventive health activities. These include health promotion, disease and injury prevention, health protection, and population health surveillance and assessment. Health Canada's Population and Public Health Branch has primary responsibility for supporting the federal initiatives.

9.5 The Population and Public Health Branch funds projects across the country that are delivered by other parties at the community level. Investment in these projects plays an important part in promoting quality of life, reducing costs to the health care system, and avoiding the loss of productivity due to ill health and injuries.

9.6 Our audit examined how the Branch sets priorities in choosing which population health programs to fund. We looked at the Branch's process for selecting, approving, monitoring, and evaluating a sample of projects in three specific programs: Canada Prenatal Nutrition Program; HIV/AIDS strategy; and the Population Health Fund. We also examined how the achievements of these three programs are measured and reported to Parliament.

9.7 The Branch does not have all the required evidence-based information that is critical for setting priorities. Sources of information include surveillance data and program evaluation. We found that the Branch lacks some of this information because it is either not co-ordinated or not available.

9.8 The Branch has a good process in place to manage its grant and contribution programs and ensure that public funds are managed properly. However, we found that management did not consistently follow its own management process.

9.9 In the fall of 2000, Health Canada's Internal Audit Directorate reported on an audit of the management of grants and contributions in the Population and Public Health Branch. One year later, management formally agreed to the recommendations and established an action plan. Timely implementation of the internal audit recommendations is crucial to correcting the identified weaknesses and improving the overall management of grant and contribution programs.

The Department has responded. Health Canada's responses to our recommendations are included in this chapter. The Department has responded positively to our recommendations and has agreed to take corrective action. In some instances, this action is already under way.

National Defence
In-Service Equipment

Chapter 10

Main Points

10.1 The Canadian Forces spend about 20 percent of an $11.2 billion defence budget to manage, repair, and maintain military equipment. About $1.5 billion of this pays for the purchase of spare parts, maintenance, and repairs; about $900 million represents the pay of roughly 15,000 military personnel who manage and support in-service equipment.

10.2 Officials told us that management had decided to reduce the readiness levels of Canadian Forces equipment because of budget constraints and because the international situation no longer warranted high levels of readiness. Although officials said that the reductions had been carefully controlled, we found the following:

- National Defence has not established an adequate system that defines standards and goals for equipment readiness or availability, and there is no unified reporting system to collect this information.
- The Canadian Forces do not complete, file, or analyze post-exercise reports on 60 percent of the exercises they conduct, nor are post-operation reports always completed, filed, and analyzed. This makes it hard to assess both the causes and the impacts of equipment availability problems.
- Data needed to track and manage equipment availability are incomplete, often inaccurate, and sometimes not compiled in the same way. This makes it very difficult—if not impossible—for management to know the true state of its major equipment platforms.

10.3 The Department has too few maintenance personnel to fully staff operational units and major maintenance depots. Equally serious, about 15 percent of its maintenance people lack the qualifications their ranks require. In addition, maintenance personnel lack much of the specialty training required in their units.

10.4 Nevertheless, the Department has been able to operate naval vessels at a more or less constant level of activity since 1995. The Army has been able to meet the increased demands of peacekeeping and peace support, almost doubling the use of its wheeled combat vehicles. The Air Force, however, has reduced its activities substantially, due mainly to budget reductions and the declining need for high readiness.

10.5 The armed services have set a variety of standards and goals for equipment availability, but the degree to which they are being met is not clear. We could not determine how well the Navy maintains its warships because the data were not available. The Army has kept the serviceability of equipment in its operational units at close to an informal minimum standard of 75 percent, with no noticeable decline in availability. The Air Force has experienced low levels of equipment availability in the last five years, and availability of the Hercules and the Aurora fleets continues to decline.

10.6 The supply system can normally deliver parts within a 30-day deadline, meets about half of 7- to 14-day deadlines, but rarely meets urgent requirements. Its level of service has been constant since 1995. Except in a few specific cases, our audit did not establish a correlation between the availability of spare parts and the availability of equipment to support operations.

10.7 In operations conducted to date, equipment availability has been adequate overall. In certain fleets, however, a frequent, recurring lack of serviceable equipment has hampered military training and operations. Departmental initiatives are under way, such as the Materiel Acquisition and Support Information System (MASIS) and Canadian Forces Supply System Upgrade (CFSSU); officials expect them to improve the management of in-service equipment and contribute to enhancing equipment serviceability and availability.

The Department has responded. Overall, National Defence agreed with our findings. The Department told us it would take steps to improve readiness information systems and data quality. It also said it was working to close gaps in training and to improve the supply of spare parts to deployed units.

Illicit Drugs
The Federal Government's Role

Chapter 11

Main Points

11.1 Illicit drugs have a significant negative impact on Canada and on individual Canadians. They are a major source of funding for organized crime and for terrorism. The economic costs, including health care (for example, HIV/AIDS and hepatitis), lost productivity, property crime, and enforcement are estimated to exceed $5 billion annually. In 1999 there were over 50,000 persons charged with drug offences and an estimated 400,000 court appearances.

11.2 If Canada is to reduce the impact of illicit drugs, it will need to address weaknesses in leadership and co-ordination, information, and comprehensive public reporting. We found the following:

- Canada requires stronger leadership and more consistent co-ordination to set a strategy, common objectives, and collective performance expectations. It must be able to respond quickly to emerging concerns about illicit drug use or the illicit drug trade. The present structure for leadership and for co-ordination of federal efforts needs to be reviewed and improved. The mechanisms for co-ordination with the provinces and municipalities also need review since they cross three levels of government.
- Information on the extent of the drug problem is sparse, outdated, or not available. In addition, federal departments lack basic management information on illicit drug efforts, such as expenditures, objectives, and results.
- There is no comprehensive public reporting. No public report clearly explains what the federal government and other levels of government are doing to reduce the demand for and the supply of illicit drugs. Neither parliamentarians nor Canadians know the full extent of the illicit drug problem and the social, economic, and health costs associated with it.

Background and other observations

11.3 In 1992 the government approved Canada's Drug Strategy, a co-ordinated effort to reduce the harm caused by alcohol and other drugs. The strategy calls for a balanced approach to reducing both the demand for drugs and their supply through such activities as control and enforcement, prevention, treatment and rehabilitation, and harm reduction.

11.4 In 1997 the *Controlled Drugs and Substances Act* was introduced. It remains the current legislation for controlling the use of illicit drugs. Since 1997, most of the government's legislative changes related to illicit drugs have focussed on supply reduction (enforcement), not demand reduction.

11.5 To co-ordinate Canada's Drug Strategy, Health Canada chairs the co-ordinating groups: the Assistant Deputy Ministers' Steering Committee on Substance Abuse and the Interdepartmental Working Group on Substance Abuse.

11.6 Federally, 11 departments and agencies spend approximately $500 million annually to address illicit drug use in Canada. The main ones are Health Canada, the Department of Justice, the Royal Canadian Mounted Police, Solicitor General Canada, the Canada Customs and Revenue Agency, Correctional Service Canada, and the Department of Foreign Affairs and International Trade. In addition, municipal and provincial/territorial governments are equally involved in addressing illicit drugs.

11.7 Some other countries engaged in addressing the problem of illicit drugs emphasize the importance of strong leadership and up-to-date management information and comprehensive public reporting. Canada has not given it the same emphasis.

The government has responded. Health Canada, responding on behalf of the government, indicated that it will consider our recommendations but has not outlined any specific action.

Follow-up of Recommendations in Previous Reports

Chapter 12

Main Points

12.1 Progress by the government in taking corrective action is uneven. In the departments' and agencies' responses to our audits, they committed to taking action and correcting deficiencies. In our follow-up work, we found many cases where they have made reasonable progress. But in other cases, progress is more limited. We encourage departments and agencies to complete the action necessary to resolve the issues raised.

12.2 Citizenship and Immigration Canada and the Immigration and Refugee Board are actively taking steps to address the issues raised in our 1997 audit. However, progress related to receiving refugee claims and handling failed claims cannot be fully assessed until the proposed legislation is passed and the ensuing regulations issued. Citizenship and Immigration Canada could not provide information on removals of failed refugee claimants that would indicate whether its processes were more effective.

12.3 National Defence is making slow progress addressing concerns that we raised in our 1999 audits of the management of hazardous materials and the risk of fraud and abuse by employees. In the case of hazardous materials management, the Department has not yet completed its national-level environmental management system. Therefore, little improvement in compliance can be expected before 2004 when this project is complete. Similarly, the Department has not yet fully implemented the Defence Ethics Program—the cornerstone of its efforts to promote ethical conduct and eliminate fraud and abuse.

12.4 In our follow-up of our 1998 audit of comprehensive land claims, we found that fundamental issues related to the current treaty negotiation process remain. These include the difficulty of achieving certainty and the length of time to reach agreements. Progress in these areas depends on the political will, co-operation, and good faith of all parties concerned. Although Indian and Northern Affairs Canada has taken action to address our recommendations, progress in evaluating the impacts of settlements and in capturing and reporting the complete costs of settling and implementing land claims is slow.

12.5 The government has not addressed our concerns about management oversight that we raised in our 1998 and 1999 audits on contracting for professional services using sole-source contracts. However, it has issued a new policy on advance contract award notices and has acted on our recommendations related to training. The Treasury Board Secretariat continues to reject our recommendation that departments with significant levels of sole sourcing be required to conduct annual assessments of their compliance with the regulations.

12.6 The Canada Customs and Revenue Agency has addressed most of the recommendations from our 1999 audit of the Underground Economy Initiative and continues to work on three other recommendations. These include providing additional performance indicators on the impact the Initiative has had on reducing the underground economy, improving selection of audit files, and reporting the additional tax resulting from underground economy audits.

12.7 The Department of Foreign Affairs and International Trade acted on all the recommendations raised in our 1999 audit of the delivery of capital projects in four missions. It has improved its planning capacity for capital projects and strengthened its guidelines for the planning of projects. The Department has also completed a comprehensive report on steps being taken to improve the management of property in the Department.

12.8 The Patented Medicine Prices Review Board has made good progress in addressing our recommendations from our 1998 audit, in particular for those areas most directly within its control. Several of the recommendations involved reviewing the *Patent Act* or regulations and consulting with Industry Canada and Health Canada. The Board has taken action on most of those recommendations as well.

Other Audit Observations

Chapter 13

Main Points

13.1 The *Auditor General Act* requires the Auditor General to include in her Report matters that she considers to be of significance and that should be brought to the attention of the House of Commons.

13.2 This chapter fulfils a special role in the Report. Other chapters normally report on value-for-money audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or audit work to follow up on third-party complaints.

13.3 This chapter covers the following:

- Human Resource Development Canada and the Canada Employment Insurance Commission—Clarity and improved transparency needed to demonstrate compliance with the *Employment Insurance Act* in setting premium rates.
- Department of Finance—Parliamentary oversight weakened in poorly targeted relief for heating expenses.
- Parc Downsview Park Inc.—Parliamentary control of programs and spending.

13.4 Although audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters not examined.

Report of the Auditor General of Canada to the House of Commons—2001

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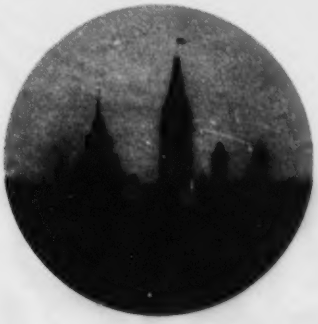

Report of the
Auditor General of Canada
to the House of Commons

Chapter 1
Financial Information Strategy:
Infrastructure Readiness

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

1

Financial Information Strategy

Infrastructure Readiness

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Financial Information Strategy
Infrastructure Readiness

Main Points

1.1 The government has made a lot of progress in the last year toward getting its long-awaited Financial Information Strategy (FIS) up and running. However, it still has a lot to do before FIS can be considered complete.

1.2 Departments and agencies have installed new financial systems that can handle the accrual accounting requirements of FIS. They have created the needed interfaces to transmit summary financial information to the FIS central systems. Now, though, departments need to stabilize these new systems, ensure that appropriate controls are in place, and provide complete, accurate financial information that managers will use.

1.3 The Treasury Board Secretariat has developed and communicated the accounting policies that will move the government to a full accrual basis of accounting, in accordance with generally accepted accounting principles for the public sector. Departments are at different stages of applying these policies and determining their opening balances for such items as tangible capital assets. The government and departments are to produce their first set of accrual-based financial statements for the year ending 31 March 2002. The current reporting model for departments does not require them, however, to record and disclose in their financial statements some significant liabilities and costs.

1.4 The government recognizes the significant change it will have to manage. Departments have change management plans at various stages of implementation. The plans include developing management reporting and training managers to use the new financial tools available to them. These plans are essential to realizing the full benefits of FIS.

1.5 The government has not progressed much toward deciding its approach to accrual-based budgeting and appropriations. Responding to a request by the Standing Committee on Public Accounts, the Secretariat said this complex issue requires extensive study before a decision is made. The government called the Committee's suggested April 2003 target date for the introduction of accrual budgeting and appropriations highly unlikely. But departments have said clearly that the change in culture demanded by accrual accounting will not happen without accrual budgeting and appropriations. We agree. Departments are worried about the added complexity during the interval when they will have to prepare the information in their Estimates on a different basis from the information in their financial statements.

1.6 In response to another request by the Standing Committee on Public Accounts, the government surveyed departments to obtain an estimate of FIS costs across government. The survey results indicated that the total cost would ultimately be around $635 million. We cannot conclude whether this estimate is reasonable because the government did not establish a framework for reporting FIS costs and ensuring that the figures were complete and accurate.

1.7 As FIS funding dries up and FIS project offices are wound down, there is a real concern that the momentum to finish the job may be lost. The government should not lose sight of its key objectives for FIS and the results it expects, such as better financial information for managers. It also needs to ensure that both it and departments produce their accrual financial statements. Then it can reassess the status of the strategy's other aspects and decide how best to ensure that they are completed.

Background and other observations

1.8 The government officially launched its Financial Information Strategy (FIS) in 1989 and, after several false starts, revitalized the project in 1995. It set April 2001 as the target for having the strategy in place across departments.

1.9 FIS is a prerequisite to the success of two other federal initiatives: Modern Comptrollership and Results for Canadians: A Management Framework for the Government of Canada. It supports three of the four key elements of modern comptrollership, and the information it provides is fundamental in linking costs to results. Our Office is currently auditing departmental plans and strategies for Modern Comptrollership and will report the results in April 2002.

1.10 In 1995, the government set several objectives for FIS: implement modern financial systems in departments and agencies, develop new central systems, introduce accrual accounting policies, and provide managers with better financial information for day-to-day decision making. Our Office supports these objectives fully.

1.11 The Standing Committee on Public Accounts continues to demonstrate strong support for FIS. The Committee recently issued two reports urging the Treasury Board Secretariat to act, particularly on the issue of accrual-based budgeting and appropriations.

The Treasury Board Secretariat has responded. The Secretariat has agreed with our recommendations and its responses to them in the chapter describe current or planned action to address them.

Introduction

The government's expectations for FIS

1.12 The federal government officially launched its Financial Information Strategy (FIS) in 1989 and, after several false starts, revitalized the project in 1995. It set April 2001 as the target for having the strategy up and running in departments and agencies.

1.13 FIS is a prerequisite to the success of two other federal initiatives—Modern Comptrollership, and Results for Canadians: A Management Framework for the Government of Canada. It supports three of the four key elements of modern comptrollership, and the information it provides is fundamental in linking costs to results. Our Office is auditing departmental plans and strategies for Modern Comptrollership and will report the findings in April 2002.

1.14 The strategy is designed in part to modernize government accounting and bring it into line with best practices in the private sector and other public sector jurisdictions. The underlying accounting policies are consistent with emerging national and international accounting standards for the public sector.

1.15 In its publication *FIS: A Summary* (January 1997), the Treasury Board Secretariat notes the objectives it set for FIS when the project was revitalized in 1995:

- Departments and agencies would select and implement new financial systems from a list of seven that were recommended—systems that would support the full accrual method of recording and reporting financial transactions.
- The government would develop new accounting policies, consistent with generally accepted accounting principles for the public sector. Departments and agencies would apply those policies and take primary responsibility for the quality and completeness of detailed information on their financial transactions. They would produce annual financial statements that could be audited.
- Government managers would have access to better financial information and would use it in their day-to-day decision making.

The Office of the Auditor General fully supports these objectives.

1.16 In *Managing for Results 2000*, the President of the Treasury Board states that the government is introducing full accrual accounting for the *Public Accounts of Canada* in 2001–02, and the final major step in improving financial information will incorporate accrual-based budgeting and accrual-based financial statements. We have found departments in near-unanimous agreement that budgeting and appropriations need to be on the same accounting basis as reporting.

Accrual—A method of accounting that recognizes the effect of transactions and events in the period when they occur, regardless of whether cash or equivalent was paid or received.

Budgeting—The process by which financial resources are allocated to government priorities and operations. New policies and projects are prioritized and then await new funding.

Appropriation—Parliament's authorization to pay money out of the Consolidated Revenue Fund.

FIS infrastructure and its relationship to the overall strategy

1.17 The infrastructure that supports FIS includes modern financial systems that can accommodate accrual accounting and transfer summary financial data monthly to the government's Central Financial Management and Reporting System (CFMRS). Departments will continue to use central treasury systems to request payments and to record deposits of cash. Procedures to ensure that financial data are complete and accurate (such as data reconciliation) and basic financial and management reporting are also necessary for FIS to succeed.

1.18 The strategy relies on getting the FIS infrastructure in place. However, that alone will not guarantee success. The strategy's success and the full realization of its benefits hinge on senior and operational managers across government using the new tools and the improved financial information as they make decisions. The strategy introduces managers to a different frame of reference, one that focusses on expenses—how resources that support program delivery are used. In essence, FIS promotes better management by allowing managers to see not just the cash costs of delivering a program but all of the costs. In time, these costs could be compared with program results.

Expense—Cost of resources spent on operations during the accounting period.

Focus of the audit

1.19 This is our fourth report on the Financial Information Strategy. In 1997, our chapter on the government's accounting function discussed issues that touched the Strategy. In 1998 we reported on the broad strategic issues more fully, noting that the government had not yet obtained strong support for FIS and commitment to it from senior management in departments. In 1999 we noted that the government had not yet taken the necessary steps to get that support from deputy ministers and senior management. With less than two years until the target date, we urged the government to "turn up the heat" and spur departments to accelerate their FIS activity. The Appendix to this chapter presents a summary of recommendations from our 1998 and 1999 reports.

1.20 In this audit, we looked at whether the government has met the expectations it had for FIS when it revitalized the initiative in 1995. Has it implemented the financial systems infrastructure? Has it made reasonable progress in developing accrual accounting policies and applying them in departments? Has it developed reasonable plans to realize the benefits of FIS?

1.21 We also wanted to know what the government has decided to do about accrual budgeting and appropriations, and whether it has prepared and reported reasonable estimates of the strategy's costs.

1.22 The audit included the Treasury Board Secretariat, Public Works and Government Services Canada, 10 departments, and 3 major cluster groups (support groups for departments using the same financial system). In addition, we drew on the results of our earlier audit work on systems controls and our annual questionnaire on the status of FIS implementation in departments. More information is available in About the Audit at the end of this chapter.

Observations and Recommendations

New financial systems

The government has implemented new financial systems

1.23 Using best practices in the development of complex systems, the Receiver General for Canada put a new suite of central systems into place in 1999 for government-wide reporting. The new systems are capable of providing financial information on an accrual basis in the *Public Accounts of Canada*, and they provide central banking and payment systems for departments.

1.24 Departments and agencies now have their new financial systems, selected from the seven acceptable choices listed by the Secretariat in its shared systems initiative (Exhibit 1.1). Fourteen departments began transmitting summary accounting information to the FIS central systems in 1999, another 21 connected in 2000, and the remaining 60 did so on 1 April 2001. The Receiver General's *CFMRS Scorecard* shows that there have been no significant technical problems in transferring this summary information to the centre.

Exhibit 1.1 The seven financial systems in the Secretariat's shared systems initiative

1. FreeBalance	32
2. Integrated Financial/Materiel System	25
3. Common Departmental Financial System	19
4. Oracle Financials	9
5. General Management Accounting and Control System	7
6. Government Financial System	1
7. Corporate Management System	1
Non-endorsed systems	1
Total	**95**

Source: Public Works and Government Services Canada

1.25 However, departments are still stabilizing and debugging their financial systems and business processes. They are having difficulty, for example, managing the process for settling interdepartmental accounts. The government is aware of the difficulty and is attempting to simplify the process.

1.26 Some departments are not fully exploiting the capabilities of their new financial systems. For example, a department may use its new financial system simply as a general ledger interface between its existing systems and the FIS central systems. This means the department has to maintain multiple systems and develop interfaces between them, adding to the complexity and costs of

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1.26 Some departments are not fully exploiting the capabilities of their new financial systems. For example, a department may use its new financial system simply as a general ledger interface between its existing systems and the FIS central systems. This means the department has to maintain multiple systems and develop interfaces between them, adding to the complexity and costs of operating them. Further, the transfer of data from one system to another requires additional controls to ensure that data in both systems are complete and accurate.

1.27 Departments may be aware of the potentially significant investments they will have to make in the next 5 to 10 years for further upgrades, maintenance, and added functionality over the life of the financial system. In general, though, they have not calculated the potential cost or determined how they will fund it. Industry experience indicates that the cost of each major upgrade can range from 20 to 40 percent of the original cost of the system.

1.28 Ensuring data integrity is an important government-wide responsibility. It is needed for creating complete, accurate, and credible financial information, including both departmental and government-wide financial statements. Creating that information includes determining the opening balances required for the new accounting policies and ensuring continually that accounting data are reliable. We expected to see that departments had plans for providing assurance that data were complete and accurate. However, in our audit visits we noted that none had written plans for quality assurance. We are concerned that departments may not have fully assumed the primary responsibility for the integrity of their accounting data.

1.29 We examined the roles that parties other than departments could play in ensuring ongoing data integrity. They include, for example, the Treasury Board Secretariat, providing overall guidance on controls; the cluster groups, developing and communicating common control practices; a department's internal audit function, providing assurance on financial systems and information; and the Receiver General, performing secondary quality review. At the end of our audit, only the Receiver General had taken significant action, establishing a central quality assurance unit.

1.30 Data integrity is also a responsibility of each department. The revised Treasury Board Policy on Internal Audit repositions the role of internal audit as a provider of assurance, including assurance that information for decision making and reporting is complete and accurate. Departments need to consider using internal audit to provide this assurance. This would contribute to the integrity of financial information within departments and would help ensure the integrity of systems and information shared across government. The Treasury Board Secretariat needs to give departments consistent support and guidance, particularly on how to engage the internal audit community in applying the new policy on internal audit. This would include providing assurance and assessing the reliability of the new financial systems. Some common guidance and tools would help make internal audit work on FIS and financial information across the government more consistent.

Policy on internal audit—Departments must have an effective, independent, and objective internal audit function, properly resourced to provide appropriate, timely assurance on all important aspects of risk management strategy and practices, management control frameworks and practices, and information for decision making and reporting.

1.31 Between January and April 2001, we audited both the controls that three departments had in place for their new financial systems and their related management and monitoring controls. We found that the controls were not adequate. However, the departments can resolve our concerns within a year if they are willing. Our concerns included weaknesses in their general controls over access to the systems and in their management and monitoring controls. Exhibit 1.2 provides an overview of our controls audits.

1.32 Departments were receptive to our findings and are taking them into account to use their systems more fully and to adopt the necessary financial controls.

1.33 **Recommendation.** The Treasury Board Secretariat should ensure that departments have adequate plans, with clear objectives, tasks, and target dates, to finish implementing their systems and maintain them to meet all FIS requirements. Departments' plans should include the following:

- developing appropriate policies, procedures, and controls to ensure that their financial data are complete and accurate; and
- complying with the Treasury Board Policy on Internal Audit.

Treasury Board Secretariat's response. The Treasury Board Secretariat agrees and will monitor the completion of FIS and the implementation of the new Policy on Internal Audit.

1.34 **Recommendation.** The Treasury Board Secretariat should provide departments with appropriate guidance to ensure data integrity across government. This guidance should include audit tools and methodology for internal audit. In addition, with the assistance of Public Works and Government Services Canada, the Secretariat should monitor the government's data integrity overall by meeting regularly with key departments and requesting their quality assurance plans.

Exhibit 1.2 Overview of our controls audits

Objective

The quality of financial information—its completeness and accuracy—is managed by applying proper controls. We wanted to determine the extent to which the controls of three selected departments could be relied upon.

Scope

We selected the Department of Canadian Heritage, Agriculture and Agri-Food Canada, and the Canada Customs and Revenue Agency (expenditure systems) to assess their internal control systems. Each recently implemented modern enterprise resource planning (ERP) systems to manage its financial affairs.

Methodology

We reviewed four basic types of controls: manual, processing, management, and monitoring.

Conclusion

We found that controls were not adequate at this time. We believe, however, that departments can resolve our concerns within a year if they are willing. Our main concerns include the following:

- Departments are not fully exploiting controls built into their systems.
- General computer controls over the financial systems are weak.
- Business process controls are also weak.
- Management and monitoring controls (primarily budget control) exist only at a basic level.
- Some managers are still using "black books" (off-line records).

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Treasury Board Secretariat's response. The Treasury Board Secretariat agrees with the need to provide guidance to departments to help ensure data integrity across government and will develop audit tools and methodology for use by internal auditors.

1.35 To foster the sharing of scarce resources, the Treasury Board Secretariat partially funded the creation of cluster groups to support each of the seven approved financial systems. Pooling expertise in particular systems and making it available was particularly useful for departments and agencies, especially smaller ones, that did not have their own resources to implement the new systems FIS would require. The Secretariat announced in September 2001 that it has established a working group to determine how the government can reduce the number of financial system clusters from the seven currently approved.

1.36 Departments have told us they see a continuing role for the cluster groups, not only in FIS but also in modernizing comptrollership, getting government on-line, and other initiatives. Consistent with the shared system concept, cluster groups could also help departments tackle a number of longer-term issues more cost-effectively. Some of these issues are maintaining and upgrading systems, assessing the practicality of using service bureaus, assuring the quality of systems and data, and developing strong control environments that include common control frameworks. The cluster groups are developing long-range plans to deal with these and other issues.

1.37 Departments and the cluster groups see the need for a three- to five-year memorandum of understanding that describes their responsibilities and provides for enough funding to continue their work for that period. Departments and the Secretariat need to work together to establish long-term governance and funding arrangements beyond the current year.

1.38 **Recommendation.** The Treasury Board Secretariat, in conjunction with departments, should determine the future role of cluster groups.

Treasury Board Secretariat's response. The Treasury Board Secretariat agrees and has launched projects to examine various aspects of the evolution of financial systems across government, including the governance and management structures required to ensure their cost-effective implementation.

Full accrual accounting

Departments are at various stages of implementing the government's new accounting policies

1.39 Under the Financial Information Strategy, departments and agencies become accounting entities in their own right, taking greater responsibility for their accounting information and producing their own financial statements using accrual accounting. They can no longer rely on central agencies to oversee the reporting of accurate and complete financial results. Some departments are more advanced than others in accepting this new responsibility.

1.40 The Auditor General's observations on the summary financial statements, published in the 2000–01 *Public Accounts of Canada*, indicate that the government has made significant progress in its move to full accrual accounting. However, it still has much work remaining to be ready for the preparation of next year's financial statements and our audit of them.

Modified accrual—The government's previous method of accounting in its financial statements; provided for accrual of certain expenses and valuation adjustments to assets and liabilities but recorded spending on tangible capital assets in the period when acquired and recognized tax revenue when cash was received.

Cash—A method of accounting that recognizes the effect of transactions only when cash is received or spent.

1.41 Historically, the government prepared its financial statements on a modified accrual basis of accounting: essentially, transactions were recorded on a cash basis during the year, and certain accrual information was prepared at year-end. In 2001–02, the government adopted full accrual accounting in accordance with the recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting Board. It issued a lot of policy guidance to departments over the past year, but this was relatively late in the life of the FIS project. The Secretariat also produced Treasury Board Accounting Standards and an accounting manual showing the kinds of accounting entries that are required.

1.42 The major new accrual accounting policies cover tangible capital assets, environmental liabilities, accrual of tax revenue, and Aboriginal claims. Auditable financial statements are another significant change for departments. We have the following observations related to the implementation of these accounting policies:

- Departments expected to finish determining their opening capital asset balances in the fall of 2001; the completeness and accuracy of their calculations have yet to be validated. Internal audit could play a key role in that validation, but many departments have not yet used their internal audit services. The Treasury Board issued a new policy effective 1 April 2001 that calls for greater involvement of internal audit in providing assurance on risk management, controls, and information used for decision making and reporting. In view of the thrust of this policy and given the importance of capital asset information for current and future decision making, we would expect departments to use their internal audit resources to validate their opening capital asset balances. Departments were told in late summer that they would receive additional funding to hire the staff they need for their new responsibilities. However, the policy and funding were issued a little too late for internal audit to gear up and participate in this validation process.
- For several years now, departments have reported some of their environmental liabilities to the Secretariat. They are making progress in assessing liabilities for the contaminated sites they have identified. The government believes that it will be able to make a reasonable estimate of its total liability based on the assessed contaminated sites but that it will not be possible to develop this estimate until March 2002. We emphasize the importance of assessing enough sites to allow for a suitable estimate in time for the 2001–02 *Public Accounts of Canada*.
- The move from a cash basis of accounting for tax revenue to one based on assessments is a significant change for the government. The Canada Customs and Revenue Agency has created a small team to carry out this change. It has made considerable progress but still has a lot of work to complete. The process it uses currently to apply the accrual

methodology is a largely manual one, which has made it difficult for the team to meet objectives and target dates.

- We have noted in the past our concern about the ability of Indian and Northern Affairs Canada to estimate the liability for Aboriginal claims by the 2001–02 deadline. It has made progress this past year but has to do a lot more work to meet the deadline.

1.43 For the year ending March 2002, our annual audit will include examining the government-wide application of accrual accounting. However, we set a higher level of materiality in our annual audit work to support our audit opinion on the summary financial statements than we would set in auditing a department's financial statements, and much higher than management should use for its own purposes. Accordingly, departments need to develop quality assurance plans that will give them confidence in the integrity of the accounting information their managers are using to make decisions.

1.44 Departments will be asked to produce financial statements starting with 2001–02. The government's present model, however, will not require them to record some significant liabilities and costs. These include environmental liabilities; allowances for loans, investments, and advances; employee termination benefits; and contingent liabilities. In addition, the financial statements will not include services provided by other departments without charge. In our view, without these items the financial statements will not provide reliable information on departments' program costs and financial positions. The Secretariat told departments that it plans to address these items once the initial phase of FIS is stable and an appropriate management control framework is in place.

1.45 The Secretariat decided that it would not require departments to include their financial statements in their 2001–02 performance reports. Given our concerns about the reliability of the statements under the present model, we concur with the decision to defer their publication.

1.46 **Recommendation.** The Treasury Board Secretariat should monitor departmental progress in implementing accrual accounting and, if necessary, take appropriate corrective action.

Treasury Board Secretariat's response. The Treasury Board Secretariat has issued a series of information bulletins requiring departmental responses on such issues as adherence to the requirements of a detailed Transition Protocol and the recording of opening balances. The Secretariat is also evaluating the financial information being provided by departments in compliance with accrual accounting standards.

1.47 **Recommendation.** The Treasury Board Secretariat should establish and communicate a target date for the publication of reliable and useful departmental financial statements.

Treasury Board Secretariat's response. A plan is being developed to guide the development of departmental financial statements and will include a framework for the devolution of certain accounting provisions that are currently recorded centrally. Training and guidelines have already been provided in support of this initiative including many workshops on the preparation of financial statements. Departments will not be required to include their financial statements in their 2001–02 performance reports. However, where an adequate control framework exists, the Treasury Board Secretariat has approved some inclusions.

Using the new financial information

Continuous encouragement and support is needed to get managers to use the new information for decision making

1.48 FIS entails more than producing financial statements. Having departmental managers use this financial information in their day-to-day managing is the ultimate goal. This means that managers must have access to the information they need and confidence in its accuracy and utility—a significant change-management challenge for departments. Their plans for managing this change are at various stages of implementation. These plans include developing management reporting and training managers to use the new financial tools available to them.

1.49 Departments and agencies have trained their financial staff in the use of the new financial systems and accounting policies. With few exceptions, however, it is only financial staff who are using the new systems, primarily to prepare financial reports and record their departmental transactions.

1.50 Reporting to management has not yet reached its potential in departments. Many are still developing reports for managers, and others have yet to provide reports to managers beyond the finance group. Generally, departments have had difficulty producing management reports because the new financial software is designed primarily for use on-line and, in general, managers are not yet working on-line with the new systems.

1.51 As a result, many departmental managers are still keeping "black books" (off-line records). The books have persisted in part because managers do not know how to use the new financial systems or may not trust that the information the systems generate is accurate or timely.

1.52 Departments have said they do not think their managers will focus on using accrual-based financial information until the government also introduces accrual-based budgeting and appropriations. The Secretariat started to study this issue again in August 2001, but until a decision is made the realization of the full benefits of FIS remains uncertain.

1.53 Departments are starting to train operational managers so they can reap the benefits of FIS. Some are trying out data warehousing tools to supply management with useful reports. Early results show promise for the integration of financial and non-financial performance information, a key aspect of modern comptrollership.

1.54 The Treasury Board Secretariat created the FIS Forum as a way for departments and agencies to share ideas and establish working groups on common issues. Membership was voluntary; those who participated found it a useful and cost-effective exercise. For example, departments could use some material created in other departments, such as policies and plans, instead of recreating it themselves. However, the FIS Forum is winding down and many working groups no longer meet. Others will continue to operate under the oversight of the Secretariat's Financial Management and Accounting Policy Directorate. In the future, the cluster groups could also be used as a vehicle for sharing lessons learned.

1.55 Departments and agencies have begun to wind down their FIS projects and integrate FIS systems, policies, and information in their operations. They will need to manage this transition carefully, with good follow-through, if the government is to realize the full benefits of FIS. To ensure that FIS is relevant to their business-line managers and regional managers, departments will have to involve and consult them fully. At least one department has used the FIS Forum working groups as a model to fully involve business-line managers and regional managers and to "operationalize" FIS. The Secretariat could help departments by providing guidance on how to integrate FIS in their operations.

1.56 **Recommendation.** The Treasury Board Secretariat should ensure that departments have adequate plans to promote the use of the new financial information in management's day-to-day decision making. The plans should include clear objectives, tasks, and target dates. At a minimum, they should cover management reporting and manager training.

Treasury Board Secretariat's response. The FIS Project Office of the Treasury Board Secretariat, in collaboration with the Working Groups of the FIS Forum, produced several important tools for use by departments and agencies. These include a generic communications plan, a plan for change management for FIS, a learning framework, several fact sheets for managers, and some case studies. Primary responsibility for the required communications, change management, and learning regimes now rests with departments. That said, the ADM FIS Steering Committee will continue to meet and monitor progress until March 2002 with support from the FIS Project Office. The comptrollership modernization initiative will include work on manager learning, cultural change, and the monitoring of departmental plans and progress.

How much has FIS cost?

1.57 The Standing Committee on Public Accounts has shown strong support for FIS. It tabled reports in 1999 and 2000 that asked the Treasury Board Secretariat for cost estimates and status reports.

1.58 The Secretariat responded by surveying departments (most recently in November 2000) and asking them to estimate their project costs from 1995, when FIS was revitalized, until the end of 2001–02. The surveys indicate that FIS will cost an estimated $635 million. That estimate includes the costs of project teams, planning, communications and change management, development of accounting policies, valuation of capital assets, financial systems, connection with the FIS central systems, and training of finance officers and program managers. It excludes costs incurred before 1995 and the potentially significant costs of maintaining and upgrading the financial systems over their useful lives.

1.59 We cannot conclude whether this cost estimate is reasonable because in the planning stages the government did not establish a clear framework to capture costs. Departments may not have prepared their cost estimates in a consistent way or identified all of the costs associated with FIS. Moreover, the Secretariat did not carry out any quality assurance to determine whether departments were consistent in responding to the cost survey.

FIS and Parliament

The budgeting and appropriations issue needs to be resolved

1.60 In early 2001, the Standing Committee on Public Accounts issued two more reports supporting our recommendations and urging the Treasury Board Secretariat to act, particularly on the issue of accrual-based budgeting and appropriations. The government responded that this complex issue requires extensive study before a decision can be made, and that meeting the Committee's suggested April 2003 target date to introduce accrual budgeting and appropriations was unlikely. Other than an initial consultation process with departments in February 2000, the Secretariat made little progress on the issue until August 2001, when it hired a manager to complete the study and make a recommendation by the spring of 2002.

Estimates—The detailed plans supporting the government's request to Parliament for authority to spend public funds.

1.61 Every department we visited told us it would like the government to make a decision. Almost all of them said that unless the government moves to accrual-based budgeting and appropriations, managers will not focus on accrual-based financial reporting. Departments are close to unanimous in asking that financial information for all purposes be produced on an accrual basis. They are worried about the interval when they will have to prepare the information in their Estimates on a different basis from the information in their financial statements. The Secretariat emphasizes that in its view, departments will simply be producing two views of the same underlying data. Resolving this issue will demand a major effort, no matter what course of action is selected.

1.62 Depending on their specific budgeting and reporting needs, some jurisdictions around the world have adopted accrual-based budgeting and appropriations, while others have decided to maintain a dual cash and accrual system. The Canadian government needs to determine and respond to its own needs.

Budget—The statement by the Minister of Finance setting out the government's projected revenues and expenditures. It contains an overview of the government's economic and fiscal projections and sets out fiscal policy for the period ahead.

1.63 Accrual-based budgeting and appropriations need to be looked at in light of the way Parliament, the government, and managers currently make decisions. Essentially, Parliament debates and approves government policies and their estimated costs. In the fall of each year, the government carries out pre-Budget consultations and departments begin to prepare their budget information. Then, normally in late winter or the spring, the government produces its annual Budget. Government officials have told us that they intend to prepare the Budget on a full accrual basis beginning possibly in 2002.

1.64 Around the same time, departments' detailed cash-based spending estimates are presented to Parliament in the Estimates and approved through appropriation acts and other acts. Starting in 2001–02, the government will prepare full accrual-based financial statements with the *Public Accounts of Canada*.

Expenditure—Cost of goods and services acquired in the accounting period, whether or not payments have been made or invoices received; includes transfer payments due for which no value is received directly in return.

1.65 The effects of full accrual accounting will have the greatest impact on the departments' operating and capital costs of delivering their programs, which in 2000–01 amounted to about $36 billion. The move to full accrual accounting does not significantly affect the larger government expenditures such as public debt charges and transfer payments to persons and to other levels of government. In 2000–01 such costs totalled roughly $139 billion of the $175 billion the government spent.

1.66 The current approach to presenting departmental budgets in the Estimates focusses on the annual cash a department needs to carry out its operations, including its investment in tangible capital assets for the current year. Parliament approves these departmental budgets through the use of annual votes (appropriation acts) or as a result of authority granted in program-enabling legislation (known as statutory items). Appropriation acts set upper limits on departmental spending.

1.67 In Chapter 18 of our September 1998 Report, we said that the key accountability documents were moving to a full accrual basis except for the Estimates and the associated appropriations (votes)—the missing link in the government's plan. As a result, Parliament is not presented with the full, accrual-based cost of government programs when its approval of the votes is sought.

1.68 We recognize that a department's annual cash requirements will continue to be important information for Parliament. In our view, however, Parliament would be better served if it also received full program cost information based on accrual accounting as part of the Estimates and appropriations process. This would ensure that Parliament received information comparable with the accrual-based information to be included in the *Public Accounts of Canada*, departmental planning and reporting documents, and the government-wide Budget.

1.69 The government needs to answer a number of questions as it works toward a decision on the budgeting and appropriations issue (Exhibit 1.3). For instance, how does Parliament want to hold departments to account for the financial costs of delivering their programs? Should Parliament approve both a department's accrual-based budget and its underlying cash requirements, thus holding departments accountable for both their full program costs on an accrual basis and their use of cash? Finding a solution that includes parliamentary review and approval of accrual-based information could provide the needed incentive for program managers to use the accrual-based information that their new financial systems provide. It could also help alleviate concerns about departments' ability to make the cultural change that accrual accounting will require.

1.70 Some other jurisdictions have adopted accrual-based budgeting and appropriations. The Secretariat needs to review their practices, consult with Parliament and other stakeholders, and decide on an approach that meets the needs of the government.

1.71 **Recommendation.** The Treasury Board Secretariat should prepare an adequate plan, with clear objectives, tasks, and target dates, for identifying a suitable approach to accrual-based budgeting and appropriations. The plan should include the following elements:

- carrying out the necessary research;
- developing options for potential approaches to accrual-based budgeting and appropriations;
- consulting departments and Parliament; and
- deciding what approach it will take.

Treasury Board Secretariat's response. The Treasury Board Secretariat agrees with this recommendation and has developed a plan to review alternative approaches to accrual budgeting, including all the elements recommended.

Exhibit 1.3 Accrual budgeting and appropriations—Questions to answer

As the government works toward a decision on the accrual budgeting and appropriations issue, there are a number of questions that it needs to answer, such as the following:

- How does Parliament want to hold ministers, departments, and their managers to account for the financial costs of delivering their programs?
- Should Parliament approve both a department's full accrual-based budget and its underlying cash requirement forecasts?
- What will be the future role of information on cash requirements?
- What are other jurisdictions doing with accrual budgeting and appropriations and could it apply to the Canadian situation?
- How do accrual-based departmental financial statements fit into the picture?
- What could be done now to start moving toward the ultimate goal?
- What legislative changes are needed, if any?
- How would the appropriation acts need to be modified to support full accrual-based information?
- What accountability structure is needed to encourage managers to use accrual-based financial information?

Completing FIS

A lot of work remains before FIS can be considered finished

1.72 The government met an important milestone on 1 April 2001, when the final group of departmental financial systems went on-line. In our opinion, however, FIS cannot be considered complete. The first accrual-based financial statements will not be finalized until the fall of 2002. And there are still several tasks that the government needs to finish. It has to stabilize financial systems, ensure that appropriate controls are in place, finish implementing its accrual accounting policies, ensure data integrity, train managers in using the new financial information, and decide its approach to

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Completing FIS

A lot of work remains before FIS can be considered finished

1.72 The government met an important milestone on 1 April 2001, when the final group of departmental financial systems went on-line. In our opinion, however, FIS cannot be considered complete. The first accrual-based financial statements will not be finalized until the fall of 2002. And there are still several tasks that the government needs to finish. It has to stabilize financial systems, ensure that appropriate controls are in place, finish implementing its accrual accounting policies, ensure data integrity, train managers in using the new financial information, and decide its approach to accrual-based budgeting and appropriations. In our view, these tasks must be completed before FIS can be considered finished.

1.73 The Secretariat is considering winding down its FIS project office at the end of March 2002, even though the government will not have produced its first tangible results from FIS. We are concerned that as the funding dries up and FIS project offices are wound down, the momentum to finish the job may be lost. The government must not lose sight of the key objectives and expected benefits of FIS. It needs to continue focussing on FIS objectives at least until the first full accrual-based financial statements are produced in the fall of 2002. Then it can reassess the status of the remaining tasks.

1.74 FIS has been under way since 1989 and has consumed a lot of resources. Parliament and taxpayers would like to see tangible benefits from this investment. We are concerned that early termination of the FIS project could jeopardize the full gains of this important initiative.

1.75 The government is considering transferring some of the uncompleted aspects of FIS to the Modern Comptrollership initiative. Others will be continued through the Financial Management and Accounting Policy Directorate. It is important that the tasks we have noted be completed, whether under FIS or Modern Comptrollership. FIS has been managed as a project with specific timeframes and deliverables and is near completion. The Modern Comptrollership initiative only recently completed its pilot stage and is just starting the implementation phase. This means that most departments are just beginning to create project teams and develop detailed plans. Accordingly, the government must carefully consider how it will ensure that the tasks remaining to complete FIS are carried out.

Conclusion

1.76 Over the last three years, departments and agencies have installed new financial systems capable of handling the accrual accounting requirements of FIS. Assisted by Public Works and Government Services Canada, they have developed the interfaces that permit their new systems to transmit summary financial information to the FIS central systems. Departments now need to stabilize their new systems, ensure that appropriate controls are in place, and provide complete and accurate financial information that managers will use.

1.77 The Treasury Board Secretariat has developed and communicated the accounting policies that move the government to full accrual accounting based on generally accepted accounting principles for the public sector. Departments are at various stages of implementing these policies and determining their opening balances for such items as tangible capital assets. The government and departments are to produce their first set of accrual financial statements for the year ending 31 March 2002. The current reporting model for departments will not require them, however, to record and disclose in their financial statements some significant liabilities and costs.

1.78 The government recognizes the significant challenge it faces to change the way managers view and use financial information day to day. Departments are at different stages of implementing their change management plans, which include developing management reporting and training managers to use their new financial tools. These plans are essential to realizing the full benefits of FIS.

1.79 The government has made slow progress toward deciding on an approach to accrual-based budgeting and appropriations. In *Managing for Results 2000*, it recognizes the importance of this decision as the final major step in improving its financial information and management.

1.80 The Secretariat carried out a survey of departments to obtain an estimate of FIS costs across government. The results of that survey showed a total estimated cost of about $635 million. We cannot conclude whether this estimate is reasonable, given our concerns about the completeness and accuracy of the information in the absence of a cost reporting framework.

1.81 In summary, the government has accomplished a lot but still has much work to finish. It should not be too quick to declare FIS a victory.

About the Audit

Objectives and criteria

In this audit, we looked at whether the government has met the expectations it had for FIS when it revitalized the initiative in 1995. Has it implemented the financial systems infrastructure? Has it made reasonable progress in developing accrual accounting policies and applying them in departments? Has it developed reasonable plans to realize the benefits of FIS?

On the systems side, we expected the Receiver General for Canada to have implemented FIS central systems that capture summary accounting information from departments and that can produce the information needed for the preparation of the government's summary financial statements. We also expected departments to have put in place financial systems that meet FIS requirements and that can provide the FIS central systems with the necessary summary accounting information. We expected that cluster groups would provide support to their member departments in meeting FIS requirements.

With respect to accounting policies, we expected the Secretariat to have developed accrual accounting policies that conform with generally accepted accounting principles for the public sector. We also expected departments to have made reasonable progress in applying these accounting policies, determining their opening accounting balances and preparing for the production of accrual-based financial statements for the 2001–02 fiscal year.

We expected that the government and departments would have reasonable plans or strategies to encourage managers to use the accrual-based information and tools now available to them as a result of FIS.

We also wanted to know what the government has decided to do about accrual budgeting and appropriations, and whether it has prepared and reported reasonable estimates of the strategy's costs.

We expected the government to have a reasonable plan for reaching a decision on the accrual budgeting and appropriations issue. We also expected the government to monitor and report on the overall progress and the costs of FIS.

Scope and approach

Our audit findings are based on interviews with government officials in central agencies, in the cluster groups, and in departments; a review of relevant documentation; a review of government-wide and departmental Web sites and information provided by departments in response to our FIS questionnaire; and our audits of controls in three departments.

We carried out our audit of the central aspects of FIS implementation at the Treasury Board Secretariat and Public Works and Government Services Canada (the Receiver General for Canada). We carried out work on departmental aspects of FIS at Human Resources Development Canada, the Canada Customs and Revenue Agency, National Defence, Fisheries and Oceans, the Canadian International Development Agency, the Department of Foreign Affairs and International Trade, the Royal Canadian Mounted Police, Transport Canada, Correctional Service Canada, the Treasury Board Secretariat (including the Department of Finance), and Public Works and Government Services Canada. The scope of the audit also included the SAP, Oracle, and FreeBalance cluster groups.

We carried out audits of controls in the expenditure systems at the Canada Customs and Revenue Agency, Agriculture and Agri-Food Canada, and the Department of Canadian Heritage.

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Appendix Summary of previous recommendations

The Financial Information Strategy: A Key Ingredient in Getting Government Right (Chapter 18, 1998 Report)

In the chapter, we discussed a number of broader strategic challenges that were important to the success of the Financial Information Strategy. While not formal recommendations, we list them here to provide some background context to the recommendations.

- Integration of FIS into departmental management.
- Moving to accrual-based appropriations.
- Obtaining departmental buy-in.

[illegible]	[illegible]	[illegible]
The Treasury Board Secretariat should implement its plans to expand its continuous risk assessment process and to monitor and facilitate the implementation of FIS government-wide to help ensure that the full benefits of FIS are achieved (paragraph 18.51).	◓	Public Works and Government Services Canada took the lead in carrying out continuous risk assessment. The Secretariat participated in this process.
The Treasury Board Secretariat and Receiver General should implement their plans to provide guidance, such as control frameworks, covering all types of transactions required for the full implementation of FIS (18.59).	◓	An overall framework and a Receiver General specific control framework were prepared.
The Treasury Board Secretariat should implement its plans to: • describe the accounting and control environment for the transition period; • provide guidance to departments on the integration of FIS into departmental decision making; and • facilitate the development of departmental plans that cover both the post-implementation FIS environment and the transition period (18.60).	◓	The transition period has now passed. Additional planning is needed for the post-implementation FIS environment, such as guidance on integrating FIS into decision-making.
Departments should develop detailed plans that set out the accounting and control requirements for both the post-implementation FIS environment and the transition period (18.61).	◒	Some departments have begun to discuss post-implementation control requirements.
The Treasury Board Secretariat should provide additional guidance to departments on the development of their departmental FIS implementation plans. To ensure that these plans are complete, departments should ensure that they include the following provisions: • management reporting requirements under the FIS environment; • a change management plan showing how management and staff will be reoriented, reorganized and retrained to meet all of the requirements of the new FIS environment, not just the systems renewal component; • periodic determination and reporting of the full life-cycle cost of their FIS implementation; • a plan for security and management controls that would be subject to an external review prior to putting the new systems into production; • a plan to manage the risks associated with the current lack of experienced, expert resources for systems implementation and enhancement; and • the role for, and training of, departmental internal audit groups in reviewing progress, reviewing risk assessments, conducting reviews of security and management controls, and establishing requirements for auditability and data integrity (18.79).	◓	Departments developed FIS plans, focussing primarily on systems and accounting policy issues. Change management plans were developed but with various degrees of complexity. Departments need to deal with controls and security issues, including review by independent audit.

● Fully addressed ◓ Satisfactory progress ◒ Some progress ○ Unsatisfactory progress

Financial Information Strategy: Departmental Readiness (Chapter 21, 1999 Report)

[illegible]	[illegible]	[illegible]
Departments and their deputy ministers should make FIS implementation a priority and make a public commitment to that effect in their departmental *Report on Plans and Priorities* documents in the spring of 2000 (paragraph 21.57).	◓	Departments signed memoranda of understanding with the Secretariat committing to implement FIS. Limited public commitment in the *Report on Plans and Priorities* documents.
Departments should designate a senior-level sponsor of the FIS initiative, someone who is in a position to promote FIS beyond the finance area (21.58).	◒	Almost all FIS projects were led or sponsored by the senior financial officer.
Departments should immediately establish dedicated FIS implementation teams that integrate systems, accounting and change management skills as well as program management representatives (21.59).	●	FIS teams were established, though some are now being disbanded.
Departments should implement a FIS awareness communications campaign for line and senior managers, highlighting how FIS will help them manage in the future government environment (21.60).	●	Departments made use of presentations and intranet. FIS Forum working groups provided communications tools.

Departments should immediately develop plans that cover all aspects of FIS implementation. These plans should include the following:
• a description of the department's future financial management environment; and
• a comprehensive timetable and plan/strategy to do the following:
  • connect the departmental financial system to the FIS central systems;
  • determine and implement appropriate accrual accounting policies and procedures needed to produce auditable departmental financial statements; and
  • move the department to the future financial management environment. This should include the following:
    • a gap analysis of the current versus future decision making environment and business processes;
    • a communications plan to increase FIS awareness and to establish two-way consultation;
    • a training analysis and plan; and
    • an analysis of the human resource competency and capability (21.61).
	◓	Departments developed FIS plans that covered most of the items in the list. These varied by department. Work is still needed in a number of areas, such as producing financial statements, training, and acquiring human resource capacity.

The Treasury Board Secretariat should immediately put in place, communicate throughout government and maintain an updated, fully integrated master implementation plan for the FIS. The plan should indicate what can be realistically accomplished by the target date of April 2001 as well as target dates for the completion of remaining aspects of FIS implementation (21.87).	◒	A high-level plan was prepared.
The Treasury Board Secretariat should immediately obtain documented commitment from departments to implement all aspects of FIS (21.88).	◓	Memoranda of understanding signed by departments, the Secretariat, and Public Works and Government Services Canada. These focussed on systems implementation.

● Fully addressed ◓ Satisfactory progress ◒ Some progress ○ Unsatisfactory progress

[illegible]	[illegible]	[illegible]
The Treasury Board Secretariat should obtain and review departmental FIS implementation plans (21.89).	◓	Departments were asked to provide plans, primarily at a general level.
The Treasury Board Secretariat should establish a reporting framework to permit the FIS Project Office to monitor departmental FIS implementation progress and costs, and to intervene if difficulties arise (21.90).	●	Done at a high level only. Status reporting was discontinued after March 2001.
The Treasury Board Secretariat should consider providing additional funding and other resources to departments where the need for such an intervention can be clearly established (21.91).	●	Additional funding for FIS was made available to departments.
The Treasury Board Secretariat should develop and implement a comprehensive communications plan to market FIS to senior government managers and provide guidance and consultation regarding change management and lessons learned (for example, case studies) (21.92).	●	The Secretariat created the FIS Forum, whose working groups provided communications and change-management tools. Senior government managers were regularly briefed on FIS.

● **Fully addressed.** The original audit finding has been fully addressed and there is no need to take additional action.

◓ **Satisfactory progress.** Substantial progress has been made in addressing the original audit finding, but some additional action is still required.

◒ **Some progress.** Some progress has been made in addressing the original audit finding, but considerable additional action is still required to achieve the desired results.

○ **Unsatisfactory progress.** Progress has not been made in addressing the original audit finding, and action remains outstanding.

Report of the Auditor General of Canada to the House of Commons—2001

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2001

Report of the

Auditor General of Canada

to the House of Commons

Chapter 2

Recruitment for Canada's Future Public Service: Changing the System

Chapter 3

Recruitment for Canada's Future Public Service: Changing the Practices

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

2

Recruiting for Canada's Future Public Service

Changing the System

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Recruiting for Canada's Future Public Service
Changing the System

Main Points

2.1 The legislative and management framework for public service recruitment requires radical change to ensure that new systems and practices will be more responsive to both the operational requirements of departments and the long-term needs of the public service.

2.2 Our review of public service recruitment found that an alternative system of short-term hiring has emerged as the main hiring practice. We found that flaws in the system prompt managers to work around what they view as an overwhelmingly cumbersome process. Systemic problems are further complicated by weaknesses in human resource planning, workload and funding pressures, and the need for improved recruitment tools, outlined in Chapter 3. These system- and practice-related problems have combined to create a culture of short-term hiring that will have significant long-term repercussions on the public service.

2.3 These issues have been studied for years. But the changes made so far have been an inadequate response to identified deficiencies and to recommendations for resolving them. The government plans to introduce legislation in 2002 to modernize the human resource management regime. We strongly support this initiative and urge the government to take quick and decisive action to meet the significant challenges it faces.

Background and other observations

2.4 The public services faces a significant "human capital" challenge—the need for enough skilled people to perform its work, given the demographic profile of the public service; a shift in the nature of work; an increasingly tight market for talent; and negative perceptions of the public service as a career choice. To address this challenge, the Clerk of the Privy Council has identified recruitment as one of three human resource priorities across the public service.

2.5 This audit examined recruitment: the actions taken by central agencies and hiring managers to ensure that the public service is hiring enough skilled people to perform its work. We looked at six departments; we focussed on recruiting in the Scientific and Professional category and the Administrative and Foreign Service category, which are the key sources of people to replace the Executive leadership group. The Executive group could experience a 70 percent loss through retirements by 2008.

2.6 We are reporting the audit in two chapters. Reading both is essential to a full understanding of the issues involved and their interrelationships. This chapter identifies problems in the recruitment and staffing system and discusses the need for legislative changes. Chapter 3 focusses on improvements that do not require legislative change: how managers and departments identify their recruiting needs; how they fill them; and what support hiring managers receive from their departments and from central agencies.

2.7 We believe that both in departments and in the broader public service, experience with fully delegated staffing demonstrates a potential for greater decentralization that should be considered in a new legislative model.

2.8 In our opinion, with three different central agencies providing reports to Parliament on different aspects of human resource management, it is difficult for parliamentarians to get a clear picture of the risks, the challenges, and the state of human resource management—conditions that could affect the outcomes of services to Canadians.

The government has responded. The response of the Privy Council Office, on behalf of the government and the departments we audited, and the response of the Public Service Commission are included at the end of Chapter 3. The government's response supports the need for legislative change. The responses recognize the need to address our audit observations and the recommendations for improving recruitment practices that we have made in Chapter 3.

Introduction

Entering the federal public service: General recruitment

2.9 Staffing in the federal public service includes initial recruitment into the government as well as promotions and lateral movements inside it. The Public Service Commission of Canada (PSC) administers staffing under the *Public Service Employment Act*. The Act covers the 20 departments and some 60 agencies that form the core public service.

2.10 Most hiring from outside is done by individual competition as needed to fill a vacant position. Sometimes several similar positions are filled from one competition. Sometimes positions are filled without competition. Sometimes candidates are selected from an inventory of applicants for occupational groups that have been advertised.

2.11 In December 2000, we reported on the Post-Secondary Recruitment Program, the government's prime vehicle for attracting and recruiting new and recent post-secondary school graduates. Its purpose is to fill specific, university-level vacancies in regular departmental operations and programs or in corporate development programs. During 2000–01, post-secondary recruitment garnered 701 recruits.

2.12 We identified a number of problems in the program, which the Public Service Commission is currently addressing. We were also concerned that the program was not recruiting enough graduates to prepare for imminent staffing gaps. The government responded that this was only one way of entering the public service; most hiring was done through general recruitment. This year our audit looked at general recruitment and how it is being used to meet the workforce challenges the government faces.

Pressures that contribute to "human capital" challenges

2.13 The public service faces a significant "human capital" challenge—the need for enough skilled people to perform its work. The Clerk of the Privy Council has identified three human resource priorities across the public service to address the challenge: recruitment (hiring new staff to the public service), retention (keeping competent staff), and learning (developing staff to ensure the continuing competency of the public service).

2.14 The key factors that affect recruitment today are demographics inside the public service; a shift in the nature of the work, requiring staff who are more highly skilled and more educated; an increasingly tight labour force that will be in more demand than it can supply; and the negative perceptions of the public service as a career choice.

2.15 **Demographics.** In December 2000, we reported that 70 percent of public service executives would be eligible to retire without penalty by 2008. A survey of executives and equivalents, undertaken in 2001 by the Association of Professional Executives of the Public Service of Canada (APEX) and Ekos Research Associates Inc., found that 40 percent actually plan to retire in the next five years, and an additional 35 percent in the next six to ten years. Employees who could replace them, those at levels just below Executive ranks who have the necessary qualifications, have a similar age profile.

2.16 At the same time, youth are underrepresented in the public service, as a result of limited hiring by the government in the period of Program Review. The proportion of employees who are under the age of 35 is about half as big in the public service as in the general workforce.

2.17 **Shifting nature of work**. The nature of work in the federal public service has shifted. The decision to delegate many operational functions to outside organizations and the increasing computerization of work have reduced the number of operational and support staff. Computerization, globalization, and an increasingly complex working environment call for higher levels of skills; more positions in the public service now require post-secondary education.

2.18 **Labour force**. As we reported in April 1998, the youth population is decreasing; by 2010, the retiring population will outnumber youth, creating conditions for major labour shortages. Private sector firms already talk about a "war for talent." Every day, newspapers predict a shortage of candidates for professional and skilled employment.

2.19 **Career choice**. Finally, the public service has an image problem. A 1999 employee survey in the federal public service and some academic studies, such as *Career Development in the Federal Public Service: Building a World-Class Workforce*, have underlined some of the problems in the workplace. Surveys of university students by the Public Service Commission have confirmed that they do not consider the public service as desirable a place to work as students once did.

New human resource legislation is planned

2.20 Our Office has been critical for some time of the government's complicated legislation and framework for human resource management, particularly staffing. We have noted the need for change to meet current and emerging human resource challenges if the Canadian public service is to continue being ranked among the best in the world. In April 2001, the government announced plans to modernize the human resource legislative regime by introducing legislation in 2002.

Focus of the audit

2.21 The purpose of our audit was to examine how well the general recruitment of individuals into the public service meets both current and future requirements. For the purposes of this audit, we have defined recruitment to mean how individuals first enter the public service and also how they become indeterminate employees. An objective was to identify current general recruitment practices and their accompanying opportunities and constraints.

2.22 The results of our audit are presented in two parts. Reading both is essential to a full understanding of the issues involved and their interrelationships. This chapter looks at the present results of recruitment and the system that produces them. Given the review of human resource legislation now under way, we do not address any recommendations to problems in the present system. At the end of this chapter, we do suggest some guiding principles for change that parliamentarians might wish to consider in their review of any new legislative framework.

2.23 Chapter 3 presents our observations on recruitment practices that need to be addressed regardless of the legislative framework. It is based on a review of six departments that represent different types; the audit observations and recommendations in that chapter apply to systems and practices across government.

2.24 Our audit focussed on recruitment into the Scientific and Professional category and the Administrative and Foreign Service category. These groups provide key administrative, professional, and managerial services to the public and are also the main feeder groups for the government's leadership ranks. In 2000–01, the two groups accounted for 38.6 percent of all hiring activity to the public service other than casual and student employment. Appendix A to Chapter 3 lists all the occupational groups in the two categories.

2.25 We looked at practices that hiring managers and human resource professionals in six departments use to recruit people. The departments were Public Works and Government Services Canada, Health Canada, Natural Resources Canada, Environment Canada, the Treasury Board Secretariat (as a department), and the Department of Finance. We selected the six departments to represent larger, medium-sized, and small departments with significant recruitment activity in the groups in our study. Four of the six departments operate across the country; two operate in the National Capital Region. Three are science-based; two have policy and central agency functions; and one provides services to other departments. In general, the larger the department, the more diffuse are its business lines and the more diverse its occupational groups and its employees' needs. Our selection of departments also took into account recent and planned audits and studies by both this Office and the Public Service Commission, in order to ensure a balanced coverage of departments and agencies.

2.26 We also looked at the support, guidance, and services that three central agencies provide for strategic direction, human resource planning, and staffing or recruitment—the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office.

2.27 We held focus groups across Canada with hiring managers and met with human resource advisors. We also conducted an Internet survey of 1,262 managers in the departments we reviewed who had hired employees in the two occupational categories in the past two years. We received 648 responses.

2.28 We looked at recruitment and the supporting staffing system. Our audit did not include recruitment of students or recruitment under the

Post-Secondary Recruitment Program, which was the subject of an audit we reported in December 2000 (Auditor General's 2000 Report, Chapter 21). We did not review other areas of human resource management, such as classification and compensation or labour relations. See About the Audit at the end of Chapter 3 for more details.

Observations

Recruitment challenges

Challenges to recruitment are being experienced now

2.29 Recruitment at all levels of the public service will need to increase to fill the shortages that impending retirements and the changing nature of work in government will create. The six departments we reviewed have identified several groups at risk because of demographics, significant departure rates (staff turnover and retirements), and competition from the private sector. (At risk means that not enough people are available to fill existing vacancies.)

An unacceptable percentage of new hiring activity is short-term

2.30 Given the priority for recruitment that has been identified for several years and the need to build now for the future, we expected that most of the hiring to the public service in the groups we examined would be for continuing employment.

2.31 According to the 2000–01 Annual Report of the Public Service Commission, general recruitment in all categories in 2000–01 resulted in 39,040 appointments to the public service, excluding students. Someone can be "hired to" the public service in one of three principal ways: indeterminate, specified term, or casual employment.

2.32 Indeterminate employment is continuing employment without a specified end date. Specified period employment (also called term hiring) has a fixed, predetermined duration (often three to six months), though it can be and is renewed often. Both of these are covered under the *Public Service Employment Act* (PSEA) and represent 51.6 percent of new hiring activity. These actions are considered appointments to the public service and are subject to the system designed to protect merit.

2.33 Casual employment (for a period not exceeding 90 days at one time or 125 days in a year) is excluded from the PSEA. Because it involves no expectation of long-term employment, it is not subject to the merit system.

2.34 While indeterminate hiring activity showed a slight increase in the past year, still only 9.9 percent was for indeterminate employment (Exhibit 2.1). Almost half of public service hiring activity (excluding students) was for casual employment, and the rest for short, fixed terms.

Exhibit 2.1 Hiring into the public service

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Indeterminate	2,269	6.4	2,874	9.8	3,856	9.9
Specified term	15,774	44.3	13,615	46.1	16,268	41.7
Casual	17,519	49.3	13,020	44.1	18,916	48.4
Total	35,562		29,509		39,040	

Source: Public Service Commission, annual reports: 1999–2000, 2000–01. Not audited.

Access by the general public to indeterminate positions is limited

2.35 While 3,856 individuals were hired directly from the general public to indeterminate positions in 2000–01, we found that the common route of entry for the general public is to be hired first as a specified-term employee and then to "compete" for an indeterminate position. The PSC reported that 6,455 people had moved from casual (255) or term status (6,200) to indeterminate status, about 64 percent of new indeterminate staff in 2000–01.

2.36 The groups in our audit displayed the same pattern. Some 58 percent of the Administrative and Foreign Service category and 62 percent of the Scientific and Professional category became indeterminate employees after having been hired first as either a term or a casual employee. Only 36 percent of people in these categories entered the public service as indeterminate employees.

2.37 Furthermore, even access to term appointments is gained through casual employment: 11.5 percent of public servants in 2000–01 had worked as casual employees immediately before their appointment as a term employee. As already noted, casual employment is not subject to the same merit process as other hiring.

2.38 Other surveys and reviews have identified the same trends. A June 2000 thematic review by the PSC on access to public service employment opportunities showed that outside applicants had a better chance at public service employment if they were willing to accept short-term jobs and if they were already known by the hiring managers on a professional basis or through previous work experience. This conclusion was based on a detailed analysis by the PSC in six departments, five of which differed from those in our audit. In March 2001, a PSC survey of newly hired employees found that a third of respondents had previously worked in some capacity in the department or agency that hired them to their first indeterminate or term position.

+6

Exhibit 2.1 Hiring into the public service

[illegible]	[illegible]		[illegible]		[illegible]	
	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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2.36 The groups in our audit displayed the same pattern. Some 58 percent of the Administrative and Foreign Service category and 62 percent of the Scientific and Professional category became indeterminate employees after having been hired first as either a term or a casual employee. Only 36 percent of people in these categories entered the public service as indeterminate employees.

2.37 Furthermore, even access to term appointments is gained through casual employment: 11.5 percent of public servants in 2000–01 had worked as casual employees immediately before their appointment as a term employee. As already noted, casual employment is not subject to the same merit process as other hiring.

2.38 Other surveys and reviews have identified the same trends. A June 2000 thematic review by the PSC on access to public service employment opportunities showed that outside applicants had a better chance at public service employment if they were willing to accept short-term jobs and if they were already known by the hiring managers on a professional basis or through previous work experience. This conclusion was based on a detailed analysis by the PSC in six departments, five of which differed from those in our audit. In March 2001, a PSC survey of newly hired employees found that a third of respondents had previously worked in some capacity in the department or agency that hired them to their first indeterminate or term position.

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Short-term solutions are shortsighted

2.39 In our opinion, the government cannot rise to recruitment challenges or become an "employer of choice" by offering short-term employment on such a large scale. Although positions lasting three to six months may look good to individuals who lack employment or are just entering the workforce, in a highly competitive labour market they are not likely to attract skilled people.

2.40 This is especially true of hiring to fill mid-level administrative and professional jobs, which the government recognizes it needs to do. The pool of potential applicants for these positions is usually already fully employed, and such people are unlikely to leave their continuing employment for an offer of three to six months with the government. Nearly 35 percent of hiring managers who responded to our Internet survey said that one of the reasons why their recruitment efforts were unsuccessful was that they could offer only term positions.

2.41 There is always a need for term hiring to replace persons on maternity or parental leave, long-term sick leave, or other leave; to staff truly short-term projects; or to deal with temporary workload increases. In our opinion, however, it is not sound practice as a basis for hiring the majority of new entrants to a workforce.

2.42 Most of the hiring from outside the public service is not for long-term employment. This reflects a short-term view and does not demonstrate that rebuilding the public service for the future is a priority. The use of short-term hiring solutions for long-term recruitment needs has arisen for a variety of reasons. In part, it is due to problems with the hiring or staffing system that this chapter will discuss. In part, it is also due to recruitment practices and problems and the culture of hiring that Chapter 3 explains, including weaknesses in human resource planning, instability of funding, the need to fill vacancies quickly due to workload pressures, and the need for improved recruitment tools.

An informal, short-term recruitment system has developed

2.43 We expected systems and procedures for general recruitment to provide a timely and cost-effective response to the current and emerging needs of the public service.

2.44 Over 70 percent of line managers in our Internet survey said that recruitment in the federal public service was inflexible, expensive, and complicated. Hiring managers and departmental human resource professionals echoed this opinion in our interviews and focus groups. In a PSC survey of 990 recently hired public servants, 74 percent of respondents did not like the slowness of hiring decisions.

2.45 Our Internet respondents reported that 57.6 percent of their recent hiring actions had taken longer than three months to complete, and 32.4 percent had taken six months or longer. A recent special PSC survey of hiring managers found that the average staffing action took five months; about a quarter took more than half a year to complete.

2.46 In our Internet survey we asked hiring managers about the impact of staffing delays on their own operations. Close to 50 percent reported increased workload for other staff; 38.5 percent experienced delays in meeting commitments; 14.4 percent noted reduced service to the public. Only 17.9 percent said there was no noticeable impact.

2.47 Managers were clearly focussed on short-term needs, and did not find the staffing process helpful for resolving pressing workload problems. One of the consequences is that they have turned to short-term solutions that, in our view, are not in the best long-term interests of the public service.

2.48 **The problems are well known and long-standing.** The problems in recruitment and staffing have long been a concern of this Office and have been studied often. Exhibit 2.2 highlights some key findings of previous government studies that go back decades.

Exhibit 2.2 Almost 40 years of problems with the recruitment and staffing system

Royal Commission on Government Organization (Glassco), 1962 report

The public service staffing system was a source of frustration, and the "merit system"—the rules, regulations, policies, and procedures designed to implement the merit principle—frustrated the principle.

Special Committee on the Review of Personnel Management and the Merit Principle (D'Avignon), 1979 report

The review observed excessive and inflexible regulations and a "slavish" adherence to universally applied regulations in the name of merit, at the expense of efficiency and effectiveness. Managers viewed the staffing system as slow, inflexible, and inefficient.

Public Service 2000 staffing task force, 1990

Staffing was unduly complex, rules-driven, and, particularly in the area of competition, applied unfairly. Managers did not feel ownership of the staffing system. They talked about it as an imposed burden. They either tolerated it with ill-disguised impatience or used their ingenuity to circumvent it.

Association of Professional Executives of the Public Service of Canada (APEX), survey of public service leaders, 2000

Almost without exception, respondents said the staffing, classification, and recruitment processes and practices were unwieldy and costly, hindered the development of a public service "of choice," and had a paralyzing effect on the entire system.

Advisory Committee on Labour Management Relations in the Federal Public Service, 2001

Managers viewed the system as too slow in recruiting and retaining the best people to meet their needs. They also found it inflexible and too great a burden. Although the system is supposed to protect employees from favouritism and similar abuses, union leaders considered it neither transparent nor fair. They did not see it as an effective mechanism for protection of the merit principle.

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The merit "principle" and the merit "system"

2.49 The Clerk of the Privy Council has been quoted as saying, "One of the things I'm most troubled by is that the existing processes and systems we have to protect merit do so in such a cumbersome way that they actually undermine merit." We agree. To understand how this came to be, it is useful to explore the evolution of the system.

Merit and non-partisanship are fundamental principles

2.50 The origins of the current *Public Service Employment Act* go back to 1918, when a major reform of the civil service was undertaken to "abolish patronage" and "make appointments to the public service upon the sole standard of merit." Before that reform, appointments to the public service were based on political patronage and partisanship. This failed to ensure that the public service was competent, limited public confidence in its integrity, and reduced its effectiveness. The principles of non-partisanship and merit have been fundamental ever since to the Canadian vision of a public service.

2.51 Merit has never been defined in law, and its explanation has been refined or changed over time, but generally it is understood to mean a candidate's fitness for the job sought. The merit principle has evolved over time, from "finding the best-qualified person among those that applied for the job" to include "individual merit" (qualifications of an individual measured against a standard), to the use today of competent or competency to mean that public servants are qualified to do their jobs.

2.52 Over the past few decades, the concept of a representative public service, reflecting the Canadian population it serves—geographically, linguistically, culturally, and racially—has been added to the core principles of merit and non-partisanship. Legislation that applies to all federally regulated employers, such as the *Official Languages Act*, the *Employment Equity Act*, and the *Canadian Charter of Rights and Freedoms*, has reinforced this as a legal requirement.

An independent agency to protect merit and non-partisanship

2.53 To protect non-partisanship and merit, an independent agency—the Civil Service Commission of Canada—was created to oversee the hiring of public servants, free from ministerial direction, and to report to Parliament. Originally holding many of the human resource responsibilities normally associated with an employer, this agency was transformed into the Public Service Commission in 1967 with the introduction of collective bargaining and the *Public Service Staff Relations Act*. The Treasury Board was designated the employer, but the responsibility for protecting non-partisanship and the merit principle remained the Commission's. Other responsibilities, such as for training and language testing, have been delegated to it by the Treasury Board Secretariat. The Commission thus finds itself playing multiple roles: as Parliament's agent in preserving a non-partisan, professional public service; as a central agency of government in training and other matters; and as a service delivery agent in providing staffing and recruiting services, expertise, and a federal presence in the regions.

2.54 The PSC has maintained a strict oversight of non-partisanship. While the existing *Public Service Employment Act* permits some ministerial staff to be appointed to a public service position on a priority basis under certain conditions, such appointments are subject to a decision by the Public Service Commission. These appointments tend to be to positions in the Executive ranks, but few are made. The Commission also provides guidance on the political involvement of public servants, reviewing requests by public servants to run for office at any level (provincial or federal) and publishing the number of such requests it gets each year, which is small. Initially, participation in political parties and political events was not allowed. Over time, however, court challenges based on the Charter have granted public servants more rights to political involvement. Our audit did not find any concerns about this principle. In our opinion, the principle of a non-partisan public service is well understood on the whole; it has been maintained and needs to continue to be maintained, as it has served the country well.

2.55 To protect merit, the Commission has a variety of tools. It establishes policies and guidelines on staffing and recruitment, creates selection standards for various occupational groups, provides training to staffing officers and managers, provides advice to departments, uses audits or studies to identify issues, and reports to Parliament. Later in this chapter we look at the Commission's overall guidelines, its audits and studies, and its reporting to Parliament. Chapter 3 considers the information the Commission produces, the training it provides, and the services and advice it gives to departments.

2.56 Over time, the PSC has delegated to departments most staffing inside the public service, adopting an advisory and oversight role for itself. It has retained the responsibility for providing corporate programs, such as post-secondary recruitment and programs to identify executives and assistant deputy ministers. It has also retained an active role in most recruitment from outside the public service.

2.57 In its 2000–01 Annual Report, the Commission states that both the key entry points to executive appointments and recruitment to all positions are the levers to ensure neutrality. It says this is why it continues to be actively involved in appointments to the executive level and in the majority of initial appointments to the public service.

2.58 We could not identify how much of the Commission's budget and resources were dedicated to recruitment and initial appointments from outside the public service. Exhibit 2.3 shows the Commission's forecast spending according to its 2000–01 estimates. The amounts do not include $9.7 million approved in June 2001 to deal with priorities arising out of the corporate recruitment action plan. The Commission dedicates less than half of its resources to its resourcing business line, which includes recruitment and initial appointment activities.

Exhibit 2.3 The Commission's forecast spending for 2000–01, by business line

Business line	Forecast spending ($ millions)	Full-time-equivalent staff
Resourcing (support to delegated and non-delegated recruitment and staffing)	61.5	641
Learning (language training and professional development for non-executives)	20.2	263
Recourse (appeals, complaints concerning appointment and promotion)	5.9	68
Policy, research, and outreach	14.3	150
Corporate services (central administration, systems, and support)	32.1*	255
Total	134.0	1,377

*Includes the costs associated with the pay equity retroactive settlement in the amount of $7,449,000.

Source: Public Service Commission, 2000–01 *Report on Plans and Priorities*

2.59 The business line accounts for 46 percent of the PSC's forecast spending and some 47 percent of its full-time equivalents. But the resourcing business line is more than just recruitment. It also encompasses activities that support delegated and non-delegated staffing. It includes such activities as program development, administration of staffing delegation, establishment of tests and standards for selection, administration of staffing priorities, recruitment and promotion, and employment equity initiatives. It also includes resourcing and exchange and development programs for the Executive group.

2.60 The Commission also noted that some of the work done in its policy research and outreach branch supports recruitment activities, as does some work in corporate services for systems. But it could not tell us how much of its overall resources were directed to recruitment activities.

2.61 Further, it is not clear to what extent the PSC's involvement in outside recruitment facilitates the hiring of meritorious candidates. It establishes the areas of selection in consultation with the departments, may provide advice on the statements of qualifications, and checks advertisements for consistency with standards and for the quality of translation. It does the pre-screening of applications, ensuring that each was submitted on time and was from the correct geographical area for the competition. It also confirms whether the applicant is a Canadian citizen and, in some cases, whether the applicant meets the educational requirements of the job. It may also conduct further tests at the request of departments.

Exhibit 2.3 The Commission's forecast spending for 2000–01, by business line

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The appeals process has shaped the merit system

2.62 Under the terms of the PSEA, the Commission cannot delegate the appeals and recourse function. According to its estimates, this is a small part of the Commission's business. In our opinion, however, the appeals process has had a major impact on the shaping of the merit system.

2.63 Our audit found that line managers are greatly concerned about the impacts of the appeal system on the hiring process. They said that human resource advisors are risk-averse and want to make the hiring process appeal-proof and complaint-proof. A 1997 study by the PSC, *Recourse—The Causes and Impacts*, had similar findings.

2.64 Jurisprudence in appeals of staffing decisions has complicated public service staffing. As we have noted previously (Auditor General's April 2000 Report, Chapter 9, Streamlining the Human Resource Management Regime), any competition within the public service and any move from term to indeterminate status can be appealed. While external competitions (open to the public) are not appealable, anyone who enters such a competition for a job can lodge a complaint. If an investigation determines that the complaint is well-founded, the Commission can direct the department to take corrective action. The PSC's decisions on appeals can be appealed further, to the Federal Court of Canada.

2.65 The appeals system is intended to protect the integrity of the staffing system, not to resolve an employee's personal concerns. It is not an individual rights dispute mechanism. An employee's appeal of a competition can be upheld and yet not necessarily alter the outcome of the competition. Where an appeal is upheld, however, the decision can affect the way departments follow the process. In our opinion, this has had a wide-ranging impact on the entire staffing system.

2.66 The PSC has tried to clarify issues through such vehicles as its Web site, bulletins, and a recent reference tool, *Recourse and Redress in the Public Service*. However, we think that document itself demonstrates just how complicated the process is. It lists five pages of mechanisms, including 18 separate motivating factors that can lead to various investigations, appeals, complaints, and grievances at a number of levels—the PSC, the department, the Public Service Staff Relations Board, and the Federal Court.

2.67 The Advisory Committee on Labour Management Relations in the Federal Public Service observed in its June 2001 report that the existing system is inefficient and complex. It stated, "The appeals process is perhaps the most pressing concern in the current recourse system. This process, created to respond to complaints related to the staffing of positions in the public service, is renowned for its slowness and its inability to resolve the problems that tend to precipitate appeals." The Committee went on to call for "major changes to streamline the existing redress mechanisms and make the redress process simpler, clearer, faster and more efficient by charging a single, experienced institution with the responsibility of mediating and resolving all complaints."

2.68 Recognizing that managers have complained about the rules-based system, the Public Service Commission has tried over the past several years to move away from a rules-based system toward a values-based framework. It expects managers to make staffing decisions through a systematic, informed, ethical balance of the eight merit values and management principles (Exhibit 2.4). This applies also to external recruitment.

Exhibit 2.4 The Commission's merit values and management principles for staffing

[illegible]	[illegible]
Results values	
1. Competency	Public servants qualified to do their jobs
2. Representativeness	A public service that reflects the labour market
3. Non-partisanship	Staffing that is free of political or bureaucratic patronage
Process values	
4. Fairness	Fair treatment of employees and applicants
5. Equity	Equal access to employment opportunities
6. Transparency	Open communication about staffing practices and decisions
Management principles	
7. Flexibility	Staffing that is adapted to organization's needs
8. Affordability and efficiency	Simple, timely, and effective staffing

Source: Public Service Commission

2.69 While the PSC emphasizes a framework of values, line managers and human resource professionals we interviewed said the processes underlying staffing (and therefore recruitment) remain detailed and bureaucratic. Given the legislative base and jurisprudence, the prescribed process is heavy.

Short-term hiring

The problems with the recruitment system encourage casual and term hiring

2.70 The problems in the recruitment system that line managers identified and that we discuss in this chapter and Chapter 3 have contributed to the increased recruitment of casual and term employees. In the view of the hiring managers, it is faster and less complicated to hire term or casual employees. They do not feel, given the workload pressures they are under, that they can have positions vacant for extended periods.

2.71 As noted earlier, appointments to the public service from outside are not subject to appeal under the PSEA. This would argue for managers hiring more employees to indeterminate status at the outset. But because the appeal process, in our opinion, has "codified" the overall merit system, exactly the

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2.71 As noted earlier, appointments to the public service from outside are not subject to appeal under the PSEA. This would argue for managers hiring more employees to indeterminate status at the outset. But because the appeal process, in our opinion, has "codified" the overall merit system, exactly the same time-consuming processes and procedures are applied to competitions outside the public service as to those inside.

2.72 The focus groups we held and managers we interviewed confirmed that the best way to get people into a job quickly is to hire them on contract or as a casual or term employee. Once the individual had demonstrated performance, the manager would look at next steps. These could include renewing the term; hiring the contract person or casual employee as a specified-term employee; holding an open or a closed competition; or appointing without competition. The PSC's *Alternative Resourcing Options Report* and its 2000 thematic review, *Access to Public Service Employment Opportunities*, bear this out.

2.73 While managers clearly indicated in our interviews and focus groups that they want to hire people who can perform, there is no formal merit process for the hiring of casual employees. Term hiring follows the merit process, but in many cases the statement of qualifications is written in a way that limits the field of applicants to a more manageable number. Further, when a closed competition is held for a position a term employee has been occupying, often there are few other candidates.

2.74 The PSC has also reported that the prevalence of short-term recruitment has had a negative impact on its capacity to attract members of designated groups. Both the PSC's review on access and its Employment Systems Review comment on this.

2.75 Despite actions to improve the recruitment situation, 40 percent of the respondents to our Internet questionnaire found that the government recruitment system has stayed the same in the past year. An additional 15 percent felt it had slightly deteriorated and 13 percent felt that it had significantly deteriorated. Twenty percent said it had slightly improved and 2 percent said it had significantly improved. In addition, 36 percent of the respondents thought that the speed of recruitment had stayed the same over the past year, 18 percent felt it was slightly slower, and 19 percent found it significantly slower. Fifteen percent said it was slightly faster and 2 percent said significantly faster.

Greater decentralization and delegation to departments works

2.76 Hiring managers told us clearly that they want fully delegated staffing authority. They want clear but broad policies and guidelines rather than the rules that have evolved under the PSEA. They want less process and red tape and more value placed on their judgment. They are prepared to be held accountable for their decisions.

2.77 The PSC has already delegated full authority to a number of departments for hiring to special professional groups. These departments may hire from outside the public service without going through the PSC. Examples in the six departments we reviewed are meteorologists in Environment Canada, nurses in Health Canada, and translators in Public Works and Government Services Canada (PWGSC). Each of these departments has the flexibility to develop a recruitment system for the special groups that meet their needs.

2.78 For its Translation Bureau, PWGSC has developed a strong partnership with the 11 universities that have a translation program. Final-year students may opt to take course work related to government translation and are paired with experienced translators. The Bureau offers jobs to the best of them. Environment Canada targets meteorology, physics, mathematics, and other science graduates with extensive course work in physics and meteorology and provides up to 42 months of training after hiring them. The trainees are paired with experienced staff to transfer knowledge. Health Canada advertises for qualified nurses in professional journals and maintains an inventory of 200 to 300 candidates.

2.79 For all three groups, line managers were highly satisfied with having control of recruitment. They especially noted the increased speed and efficiency. We also note that hiring for all three groups has been to indeterminate status immediately, based on sound knowledge of short-term and long-range plans.

2.80 We also surveyed some 15 federal Crown corporations and separate employers who are not governed by the PSEA. These employers do not have the same restrictions on hiring, nor is "merit" in their legislation. In general, their governing legislation gives the chief operating officer the right to hire "such employees as are necessary for the conduct of business."

2.81 These organizations are governed, however, by federal labour codes (either the *Canada Labour Code* or the *Public Service Staff Relations Act*), the *Canadian Charter of Rights and Freedoms, Canadian Human Rights Act, Official Languages Act, Employment Equity Act*, and sound business practices. Many of their employees are represented by unions that also represent public servants.

2.82 All of the Crown corporations or separate employers we surveyed said they hired on the principle of merit, which they defined in various forms as finding the person best qualified for the job or the person who best met their needs. They also have to manage the issues of diversity and representativeness. From the outside, their policies do not look much different from those in the federal public service, but they reportedly are more adroit in hiring and take less time to fill officer-level jobs, from two weeks to three months.

2.83 Over the past few years, more than 50,000 public servants were moved from the "core" public service to separate employers, in some measure to escape the complex human resources regime. These separate employers included the Canada Customs and Revenue Agency (about 43,000 employees, formerly Revenue Canada), Parks Canada (about 3,900 employees, formerly part of the Department of Canadian Heritage), and the Canadian Food Inspection Agency (about 4,500 employees, from four departments). Similarly, in the 1980s the Post Office Department (50,000) and the National Museums of Canada (1,000) became Crown corporations. None of these organizations is any longer under the *Public Service Employment Act*.

2.84 The Act establishing the new Canada Customs and Revenue Agency gave employees of that organization the right to be treated as though they were employees within the meaning of the PSEA, for the purpose of competing for positions in the core public service. It also gave the Public Service Commission the right to review whether the Agency's principles governing its staffing programs were compatible with the staffing values of the rest of the public service. In its 2000–01 Annual Report, the Commission noted that this compatibility did exist, supporting mobility between the Agency and the public service.

2.85 We believe the experience of fully delegated staffing in departments and in the broader public service demonstrates a potential for greater decentralization that should be considered in framing a new legislative model.

Insufficient change

Despite much study and analysis, insufficient change has happened

2.86 We expected that the Commission would act in response to deficiencies identified and recommendations made in previous audits, evaluations, and studies.

2.87 The Public Service Commission used to audit individual departments on a cyclical basis as a means of protecting merit. These audits focussed on process and on whether the correct procedures were followed and documented. As part of its move to a values-based staffing system and away from an emphasis on the rules, the PSC no longer conducts individual staffing audits of departments.

2.88 The Commission has replaced these audits with thematic studies on special topics, which are intended to throw light on how well the values are understood and reflected in practice. Over the past year, the PSC has taken a variety of actions to improve its understanding of staffing trends and report on them. These actions include a Staffing Accountability Early Warning System, a Programme of Special Surveys, monitoring of appeals and investigations, and initiatives related to levels of service and performance indicators. We looked at many of these reports in our audit. We note that the reports identify many problems, analyze underlying causes, and present findings, but stop short of making recommendations. While the reports inform the work of the Commission and its policy arm and are shared widely with deputy ministers and departments, it is not clear to what extent the problems they uncovered are being addressed—there is no formal tracking system or follow-up on them.

Reporting on recruitment

Parliament lacks a comprehensive report on human resource management

2.89 We expected that there would be adequate reporting to Parliament on recruitment strategies, programs, and results.

2.90 Three central agencies all provide reports on aspects of human resource management in the public service.

2.91 In 1992, amendments to the *Public Service Employment Act* named the Clerk of the Privy Council as the Head of the Public Service. The Act requires the Clerk to submit a report annually to the Prime Minister on the state of the public service, a report that is also sent to Parliament. These reports have identified general issues and have been the vehicle for establishing broad-based, public-service-wide priorities, but they have given little specific information on expected or actual performance.

2.92 The Treasury Board, as the employer of the public service, provides a number of reports to Parliament with implications for human resource management. They include reports on official languages and on employment equity, required by federal law, and a report on employment statistics that identifies employment trends in the federal public service. That report includes major changes in the composition of the federal public service workforce in recent years. It includes such information as the size of the public service; the changing proportion of employees in occupational groups, by employment type; and some demographic data. In most cases, however, the focus is on historical trends and not on future projections.

2.93 In 1998, the Treasury Board Secretariat developed a comprehensive framework for good human resource management in the public service. It identified success criteria, performance indicators, and possible sources of information for a variety of human resource areas, including recruiting and staffing. However, reports on plans and priorities and the performance reports of the departments we audited do not reflect the use of this framework.

2.94 The PSC is required by its legislation to provide Parliament with information on the transactions and affairs of the Commission and on actions taken concerning recourse, exclusions, and employment equity. This legislative requirement is strongly oriented to activities and, as we have already noted, the Commission's annual reports have not provided Parliament with a clear view of how merit is being protected and how departments and agencies have complied with the *Public Service Employment Act*. In our opinion, the legislative requirement for data on transactions does not serve well Parliament's understanding of the merit system's performance.

2.95 In its 1999–2000 report, the Commission announced that it would report on the overall health of the merit system in its annual report, and on its own performance in its departmental performance report.

2.96 In 2000–01, as part of its new Staffing Delegation and Accountability Agreements, the PSC piloted Staffing Performance Reporting. This program requires departments and agencies to submit an annual report on how their use of their delegated authority has reflected the eight staffing values, and to give specific measures of performance. This year, all departments are required to report. The Commission intends to use this information to support its assessment of the health of the merit system in its annual report.

2.97 In its 2000–01 report, the Public Service Commission revamped its format to report against the staffing values, using the departmental performance reports, its thematic studies, and special surveys. The report focusses more on the overall health of the staffing system than it has in previous years. It includes a section on major issues affecting the staffing system, which identifies many of the issues we raise in Chapter 3. These include demographics, diversity and representativeness, access to employment, reliance on short-term temporary staffing, and capacity of the human resource management community. While the detailed discussion in the narrative of the report clearly identifies some problems, in our view the summary assessment information does not adequately convey the extent of the problems in the basic functioning of the system.

2.98 The report contains statistical information on the Commission's transactions, as the current legislation requires. However, there is minimal analysis of the data and trends. And the data do not provide a clear picture to Parliament of issues that need to be addressed.

2.99 The Public Service Commission's performance reports and reports on plans and priorities focus on its departmental activities. The performance reports do not present information on the outputs generated by these activities, such as hiring the right people and doing so in a timely way. Further, the reports on plans and priorities fail to clearly identify the expected outcomes of the planned activities. Consequently, Parliament is not able to determine the extent to which the Commission's work contributes to the health of the public service.

Reporting on human resource management can be improved

2.100 In our opinion, with three different central agencies providing reports to Parliament on different aspects of human resource management, it is difficult for parliamentarians to get a clear picture of the risks, the challenges, and the state of human resource management—conditions that could affect the outcomes of services to Canadians.

2.101 In our April 2000 Report, Chapter 9, Streamlining the Human Resource Management Regime, we noted, "Reporting to Parliament on performance in human resource management needs to improve significantly. To exercise its stewardship for this aspect of government operations, Parliament needs to get better information on how systems perform and how senior managers discharge their responsibilities." We are still concerned that Parliament is not informed about key challenges that affect the functioning of the public service.

Legislative change is required

2.102 In April 2000, we reported that while improvements were being made in the right direction, the staffing process was still a major source of frustration. This audit further confirmed our view that not enough corrective action has been taken.

2.103 We have not made specific recommendations to address the problems we have found in the present system. We believe the government needs to rethink and redesign the entire system rather than tinkering at the margins.

2.104 The government announced plans in April 2001 to introduce modernized human resource legislation in 2002. This Office agrees that legislative change is needed, change that should reflect the concerns raised in this chapter and in previous reports.

2.105 There is a need to separate process and guiding principles from legislation. The challenges that today's public service faces, the composition of its workforce, and the means that it can use, such as the Internet, are vastly different from those of the 1960s when the present legislation was written.

2.106 In reflecting on the lessons from this audit and previous work that examined recruitment issues and some underlying problems, we have outlined some guiding principles for change.

- Human resource legislation should be streamlined and simplified.
- The concepts of a non-partisan public service, able to provide service in both official languages, staffed with competent employees, and representative of the Canadian population it serves are key.
- The legislation should stay at a fairly high level, leaving the operational arrangements to a framework of policy and guidelines within which individual departments would work to address their specific challenges, taking affordability and efficiency into account.
- Any legislation should provide clear direction on responsibilities and accountabilities.
- It should clearly define the role of deputy ministers for the management of human resources in their departments.
- There needs to be a strong accountability regime with strong consequences for inappropriate or poor management of this key resource. Annual reporting to Parliament on human resource management in departments is needed. As well, some form of comprehensive, cyclical reporting on human resource management by departments to Parliament might be considered. Parks Canada's legislation requires such reporting.
- Some form of external oversight function should be in place to provide Parliament with assurance on human resource management. This function should be completely separate from any corporate operational unit needed.

Conclusion

2.107 We undertook this audit to examine how well the general recruitment of personnel into the public service meets both current and future requirements. Our audit found, and many previous public reports have said clearly, that the public service faces a looming "human capital" challenge due to the aging of its workforce, previous hiring and downsizing initiatives, a shift in the nature of work, and the tight labour market expected in the future.

2.108 The public service of the future must be rebuilt on a foundation of attracting both new graduates and seasoned professionals to fill the upcoming vacancies. As recent hiring trends show, this is not occurring. Hiring activity is focussed more on short-term operational needs than on the long-term recruitment needs of the federal public service.

2.109 We are concerned that some significant recruitment problems have been identified already and yet few plans of action have been completed to address them.

2.110 We are also concerned that an alternative system of short-term hiring has evolved as managers work around the more complex system for indeterminate hiring. Our review of general recruitment found that flaws in the system prompt managers to work around it rather than within it. Added to the weaknesses in human resource planning, funding, and individual practices outlined in Chapter 3, hiring managers focus more on hiring for the short-term. This will have significant long-term repercussions on the public service.

2.111 In our opinion, the government cannot build the workforce that will give Canadians an outstanding public service in the future if it offers only short-term jobs to prospective employees. It will have to attract and hire people to mid-level scientific, professional, and administrative positions—people who likely are already employed elsewhere. Current general recruitment practices do not provide a strong enough foundation for meeting current and future requirements.

2.112 All of these issues have been studied for years. But the changes made so far have been an inadequate response to the identified deficiencies and the recommendations made for resolving them. The legislative and management framework for recruitment requires radical change to ensure that the new system and practices will be more responsive to both the operational requirements of departments and the long-term needs of the public service. At the same time, the public service must continue to be non-partisan, competent, and representative.

2.113 The government plans to introduce legislation in 2002 to modernize the human resource management regime. We strongly support this initiative and urge the government to take quick and decisive action to meet the significant challenges it faces.

Chapter

3

Recruiting for Canada's Future Public Service

Changing the Practices

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Recruiting for Canada's Future Public Service

Changing the Practices

Main Points

3.1 Our review of public service recruitment identified a culture of short-term hiring. Due to workload pressures, departments often fill vacancies with casual and term employees instead of hiring indeterminate staff. These actions are driven by the delays and problems associated with the existing recruitment and staffing system and by inadequate human resource planning and recruitment practices.

3.2 We found weaknesses in some key areas:

- The absence of comprehensive human resource planning that is integrated with operational business plans means that senior management does not have the information it needs to develop recruitment strategies. Senior management lacks information to identify the funding needed to support recruitment, and hiring managers do not focus on the broader long-term needs of the organization.
- Hiring managers need more central and departmental inventories of pre-qualified individuals that they can draw from quickly to meet their recruitment needs.
- The government needs to upgrade its Internet-based electronic recruitment system to provide better service both to applicants and to the managers who need staff.
- Improvements need to be made in the analysis of recruitment-related information and in reporting to senior management on issues, opportunities, risks, and threats.

3.3 A more global view of human resource management is needed to break the cycle of meeting recruitment needs one job at a time and to ensure that actions will be taken to meet present and emerging needs. Hiring managers need to look beyond the short-term filling of vacancies to ensure that recruitment they undertake will meet both immediate and long-term operational needs.

3.4 Human resource advisors need to change their focus from rules-based control of the process to working with line managers using a more strategic and service-oriented approach.

Background and other observations

3.5 This audit examined recruitment: the actions taken by central agencies and hiring managers to ensure that the public service will have enough skilled people to perform its work. We looked at six departments; we focussed on recruiting to the Scientific and Professional category and the Administrative and Foreign Service category.

3.6 The audit is reported in two chapters. Chapter 2 focusses on problems in the recruitment and staffing system and the need for legislative change. In this chapter we focus on improvements that do not require legislative change. We look at how managers and departments identify their recruiting needs, how they fill them, and what support hiring managers receive from their departments and central agencies.

3.7 The public service already faces hiring challenges and shortages in almost half the occupational groups we reviewed. The situation will worsen due to changing demographics, anticipated retirements, shifts in the nature of work, and competition from both the private and the public sector for candidates.

3.8 The public service of the 21st century needs effective recruitment tools and support that respond quickly and efficiently to its needs. If it continues to take months to fill vacancies, good candidates will accept work elsewhere. Concentrated effort will be needed by all parties concerned to attract and retain the candidates the government needs in an increasingly tight labour market.

The government has responded. The response of the Privy Council Office, on behalf of the government and the departments we audited, and the response of the Public Service Commission are included at the end of this chapter. The responses recognize the need to address our audit observations and the recommendations we have made for improving recruitment practices.

Introduction

3.9 The Public Service Commission of Canada administers recruitment into the federal public service under the *Public Service Employment Act* (PSEA). Like other human resource functions in the federal public service, recruitment is shared among the Commission, departments and agencies, and the Treasury Board Secretariat.

3.10 The Commission provides some workforce and labour market information on employment equity groups to support strategic human resource planning. It is responsible for delivering government-wide recruitment programs and providing information on recruitment, diversity, and best practices. The Commission has delegated much of the responsibility for internal staffing to departments. It has delegated full recruitment responsibility for a few occupational groups to specific departments who are the prime users of those groups. However, it retains responsibility for all other recruitment to the public service.

3.11 Departments and agencies do their own human resource planning to identify their recruitment needs. They are delegated the authority to decide whether to seek candidates outside the public service (known as an open competition). They discuss the area of selection with the Commission and provide Commission staff with a statement of qualifications and a draft poster for the position. Once the PSC has done the initial screening of candidates, the department makes the recruitment and selection decisions that meet its business needs.

3.12 The Treasury Board Secretariat is responsible for developing, communicating, and evaluating human resource policies and instruments that help departments manage their human resources. It carries out some corporate human resource planning and develops and funds corporate recruitment and employment equity programs for the government as a whole.

Focus of the audit

3.13 The purpose of our audit was to examine how well the general recruitment of individuals into the public service meets both current and future requirements. For the purposes of this audit, we have defined recruitment to mean how individuals first enter the public service and also how they become indeterminate employees. An objective was to identify current general recruitment practices and their accompanying opportunities and constraints.

3.14 The results of our audit are presented in two parts. Reading both is essential to a full understanding of the issues involved and their interrelationships. Chapter 2 focusses on the problems associated with the recruitment and staffing system of the federal public service; we identified a need for significant legislative changes. This chapter presents our observations on recruitment practices that need to be addressed regardless of their legislative framework. It is based on a review of six departments that represent the different types of departments; the audit observations and recommendations in this chapter apply to systems and practices across government.

3.15 Our audit focussed on recruitment into the Scientific and Professional category and the Administrative and Foreign Service category. These groups provide key administrative, professional, and managerial services to the public and are also the main feeder groups for the government's leadership ranks. In 2000–01, the two groups accounted for 38.6 percent of all hiring activity to the public service other than casual and student employment. Appendix A lists all the occupational groups in the two categories.

3.16 We looked at practices that hiring managers and human resource professionals in six departments use to recruit people. The departments were Public Works and Government Services Canada, Health Canada, Natural Resources Canada, Environment Canada, the Treasury Board Secretariat (as a department), and the Department of Finance. We selected the six departments to represent larger, medium-sized, and small departments with significant recruitment activity in the groups in our study. Four of the six departments operate across the country; two operate in the National Capital Region. Three are science-based; two have policy and central agency functions; and one provides services to other departments. In general, the larger the department, the more diffuse are its business lines and the more diverse its occupational groups and its employees' needs. Our selection of departments also took into account recent and planned audits and studies by both this Office and the Public Service Commission, in order to ensure a balanced coverage of departments and agencies.

3.17 We also looked at the support, guidance, and services that three central agencies provide for strategic direction, human resource planning, and recruitment—the Treasury Board Secretariat, the Public Service Commission, and the Privy Council Office.

3.18 We held focus groups across Canada with hiring managers and met with human resource advisors. We also conducted an Internet survey of 1,262 managers in the departments we reviewed who had hired employees in the two occupational categories in the past two years. We received 648 responses.

3.19 We looked at recruitment and the supporting staffing system. Our audit did not include recruitment under the Post-Secondary Recruitment Program, which was the subject of an audit we reported in December 2000 (Auditor General's 2000 Report, Chapter 21). We did not review key areas of human resource management, such as classification and compensation or labour relations. See About the Audit at the end of this chapter for more details.

Observations and Recommendations

Staff shortages already exist

3.20 To accomplish their goals and objectives, departments and agencies need competent, trained people. Attracting and retaining them is increasingly difficult for a variety of reasons, including significant departure rates (staff turnover and retirements) and competition from the private sector.

3.21 Almost half the occupational groups we reviewed in the six departments already face hiring challenges, particularly for positions that require experience. These groups include architects, biologists, chemists, computer scientists, doctors, engineers, economists, forestry specialists, human resource officers, financial managers, information service specialists, meteorologists, nurses, physical and research scientists, policy analysts, program managers, purchasing officers, and translators.

3.22 Most are facing shortages because they must compete for candidates with both the private sector and other public sector jurisdictions. There is also competition for staff within and among departments, which creates additional pressures.

3.23 This chapter discusses issues that the government needs to address, regardless of the legislative framework:

- human resource plans and recruitment strategies;
- recruitment practices, funding, and tools;
- recruitment services to managers; and
- departmental reporting.

Planning and strategies

Lack of integrated human resource planning hampers development of recruitment strategies

3.24 We expected that public-service-wide demographic analysis and human resource planning would be undertaken to provide a solid basis for identifying recruitment needs.

3.25 Long-term human resource planning by departments and the public service as a whole can give management a clear understanding of both short-term and long-term human resource needs. Managers can then make more effective recruitment decisions and can staff programs and services accordingly.

Central guidance and support for human resource planning are evolving

3.26 Both the Treasury Board Secretariat (TBS) and the Public Service Commission carry out some aspects of government-wide human resource planning. Both have sections that do forecasting, demographic analysis, and research. Both deal with the public service as a whole and with "functional communities." Functional communities are groups of employees who work in common or similar functions across many government departments; the science and technology community is an example. Most of these communities are in the occupational groups our audit covered (see Appendix B for a list).

3.27 The Treasury Board Secretariat's Strategic Planning and Analysis Division is responsible for developing human resource strategies and policies for the federal public service. Units of this Division are responsible for recruitment policy, human resource strategic planning, demographic analysis and research, and human resource information.

3.28 The Division has developed guidelines and references for departments to carry out demographic analysis, trend analysis, and forecasting for such issues as succession planning. It has developed a human resources strategic planning framework, including a Human Resource Planning Template. It also co-ordinates the Human Resources Planning Interdepartmental Network, which has a Web site for sharing information and practices. It recently produced a global overview of public service employment, analyzing the implications of an aging workforce and identifying the future recruitment needed to maintain public service employment at present levels. The Division has conducted a number of studies of the human resource management community and the information technology/information management community.

3.29 The Research Directorate of the Public Service Commission also carries out demographic analysis, modelling, and labour market analysis for employment equity groups. It researches comparative developments in recruitment, employment equity, and other related practices in both the public and the private sectors. It has prepared demographic studies of some functional communities, such as the regulatory and inspection community, which includes among its 14 occupational groups many in our area of study. Some other functional communities are the communications community, the materiel and supply management community, and the executive management community. In addition, the Commission has produced regional profiles, labour market analyses, studies of employment equity groups, and studies of merit systems in other jurisdictions.

3.30 Recognizing that their forecasting and planning work overlap, the TBS and the Commission held meetings in December 2000 to establish a joint Centre for Demographic Studies. This will provide data analysis and forecasts for the public service that can be used by various stakeholders. It will not do human resource planning itself but will provide, at departments' request, the common statistics and analysis to do their own planning. The Centre will establish a single common database so information coming from central agencies will be consistent. It also plans to train departmental staff to use the tools, techniques, and data it develops.

3.31 However, the TBS and the Commission will still retain their separate research responsibilities. The Commission will continue to do labour market analysis for employment equity purposes, and the Secretariat will analyze terms and conditions of employment and conduct pay research.

3.32 In our opinion, it is too early to assess the success of this "virtual" joint organization and whether it will address the overlap of roles and responsibilities for demographic information and research.

Demographic information is improving

3.33 We expected that demographic information would serve as a basis for analysis in developing human resource plans.

3.34 In our 1998 Report, we noted that departments lacked sufficient information on their human resources. We said they needed to review the composition and competency profiles of their current staff and prepare plans to meet identified future challenges.

3.35 In this audit, we found the situation had improved. In 2000, the Clerk of the Privy Council called for deputy ministers to provide specific plans for analyzing their departments' demographics and to set three-year recruitment targets, including employment equity targets. This call has raised awareness of the implications of demographic changes and increased the focus on them.

3.36 All of the departments we looked at were able to provide us with demographic data and analyses of historical trends. They have a good overview of their current staffing situations and their projected retirements. All of the departments have identified specific occupational groups at risk. Some of the departments, such as Health Canada, Natural Resources Canada (NRCan), and Public Works and Government Services Canada (PWGSC), have detailed breakdowns of their demographic data by business line or region.

3.37 We found, however, that the demographic information available is usually at the macro level. More detail and analysis are often needed to determine specific recruitment needs. Most departments have demographic information about potential retirements but less information about actual retirements planned by employees. In addition, most forecasts are based on maintaining the organization at present levels, with little consideration of how needs could change in the future.

3.38 We saw little evidence that departments relate their own situations to the overall demographic analysis that central agencies have done. Nor do they draw on the services that central agencies provide, with the exception of Health Canada and the Department of Finance, who requested and received support from the Commission's Research Branch.

3.39 Very few departments have qualitative information on potential gaps in skills and potential new requirements. However, we found that where the Commission has delegated full recruitment responsibility to a department for certain occupational groups, the department has usually gathered and analyzed the information in more detail. Examples are PWGSC for translators, Environment Canada for meteorologists, and Health Canada for nurses.

3.40 In summary, although more demographic information is available for human resource planning, departments need to translate it more effectively into concrete recruitment strategies.

Human resource planning varies among departments

3.41 We expected that departmental human resource planning would be based on demographic analysis and integrated with departmental strategic and operational plans to help ensure that departments have the people they need.

3.42 The six departments we reviewed illustrate the breadth of challenges faced by public service managers. Among the six departments, human resource planning varies greatly. All of them have a document they call a human resource plan, but the quality of these documents varies

considerably—from a plan in development (NRCan) to a detailed plan (Department of Finance). However, few have specific recruitment targets identified to respond to current or anticipated staff shortages. Nor do they discuss related opportunities, threats, and risks. The plans made little mention of how extensively the departments use contractors and temporary service agencies and with what impact on recruitment. Exhibit 3.1 provides some key recruitment-related elements of a human resource plan.

Exhibit 3.1 Recruitment elements to consider in developing a human resource plan

1. Demographic data (global, by division, and by occupational group) and analysis of trends and impacts on the organization.
    - Raw data on age, years of service, date of retirement eligibility, and other information such as departure trends, extent of internal movement (acting appointments, deployments, transfers, and assignments), use of contractors and temporary service agencies, and employment equity information.
2. Identification of staff shortages and anticipated vacancies by division, occupational category, and level, based on historical turnover rate, current and planned operational responsibilities, and validation of upcoming retirements.
    - Identification of how to address shortages, surpluses, and anticipated vacancies through recruitment, succession planning, training and development, acting appointments, deployments, transfers, assignments, and return of employees from extended leave.
3. Development of a recruitment strategy to respond to issues raised.
    - Clear and measurable recruitment-related goals and expectations to deal with the issues raised in the human resource plans.
    - Detailed, measurable action plans to respond to issues raised, including costs, approaches to be undertaken, sources of supply of recruits, timing of activities.
    - Specific accountabilities assigned for implementation of the plan.
    - Structured follow-up and reporting on progress against plans.
4. Other areas that require departmental or service-wide action.
    - Discussion of staff retention and the extent of departures and their reasons.

3.43 Although departments have developed human resource plans, we found that the plans are not well communicated, understood, or accepted by line managers. In response to a question in our Internet survey on whether their departments have formal human resource plans, about half the managers said either that no plan existed or that they did not know or were not sure. Only 22 percent said the department had a formal human resource plan that helped them plan recruitment. An exception was line managers in the Department of Finance, where 91 percent of those responding said there was a plan, and 57 percent said it helped them in planning recruitment. The Department had held "town hall" meetings with all staff to communicate the results of its human resource plan.

Departments need to develop recruitment strategies

3.44 The value of a human resource plan is limited if it is not integrated with the department's strategic and operational plans so that recruitment strategies support the department's operations.

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Departments need to develop recruitment strategies

3.44 The value of a human resource plan is limited if it is not integrated with the department's strategic and operational plans so that recruitment strategies support the department's operations.

3.45 Although some departments have taken action in specific regions or sections, we found little evidence that any but Finance have made much progress in integrating their human resource plans with their business plans. Nor did we find that departments translate their needs into specific recruitment strategies with targets, detailed marketing strategies, timelines, and persons assigned to lead the strategies.

3.46 Departments have a variety of reasons for not completing recruitment strategies. Throughout much of the 1990s they focussed on cost reduction and downsizing. In addition, many departments have only recently had available the demographic information that clearly showed the problems they would soon be facing.

3.47 The absence of comprehensive human resource planning that is integrated with operational business plans means that management does not have the information it needs to develop a recruitment strategy and identify the funding needed to support it. Without a clear idea of their emerging or long-range needs, managers do not recruit for the future; they focus more on filling vacancies one by one as they arise.

3.48 The weaknesses in human resource planning and the absence of recruitment strategies in departments means they are not in a position to identify recruitment problems that might be dealt with public-service-wide. As a result, central agencies are not alerted to potential staff shortages across departments. If they were, they could plan for more effective, efficient, and economical recruitment to fill common gaps throughout the public service.

3.49 **Recommendation.** Deputies should ensure that human resource planning is an integral part of business planning, that the key recruitment elements and strategies are included in their human resource plans, and that the plans are communicated widely.

Recruitment practices

A culture of short-term hiring—Recruitment practices need to change

3.50 We expected that procedures for general recruitment would respond in a timely and cost-effective way to the current and future needs of the public service.

3.51 Chapter 2 discusses the potential for more delegation of recruitment to departments. Coupled with this delegation is a requirement to manage human resources, recruitment, and funding with a broader, department-wide focus.

3.52 Managers in our focus groups complained about their high staff turnover. Each time a position is vacated they have to fill it again and train another employee, resulting in lost time and lowered productivity. It is clear from our interviews with hiring managers that they are dedicated to making their programs succeed. They note that to do this, they need competent staff. Our interviews with managers showed that there are several factors affecting their recruitment behaviour and decisions:

- the need to fill some positions temporarily while employees are on assignments or on lengthy leaves (for example, parental or disability);

- the need to fill vacancies quickly due to workload pressures;
- a desire to "try before you buy"; and
- the concern that funding for their programs may not be stable enough for indeterminate hiring.

All of these contribute to the culture of short-term hiring.

3.53 In our opinion, these factors, along with a lack of nimbleness in the system and a lack of planning, have contributed to high levels of casual and term hiring activity. Managers will need to change their mindset on recruitment to ensure a better balance between the immediate need to fill vacancies and the strategic needs of their departments. But this will take leadership, direction, and support.

3.54 **Temporary assignments.** Managers said the creation of departmental or government-wide task forces and other temporary projects usually results in the rapid secondment, deployment, or assignment of already knowledgeable employees from one section of the organization to another. Secondments and assignments are faster than the regular staffing process. Positions vacated temporarily as a result must be filled temporarily, sometimes from elsewhere in the department by internal secondment or an acting assignment, creating a domino effect. Sometimes the position is filled directly through term hiring. However, back-filling the vacancies with term employees has administrative repercussions. The extent to which an organization uses internal secondments, temporary assignments, and term hiring needs to be analyzed to ensure that it is appropriate.

3.55 **Internal competition.** Managers told us that their employees in common occupational groups across the public service (such as administrative officers, computer specialists, economists, human resource officers, program managers) are often "poached" by other departments that can offer a more desirable opportunity. To fill the resulting vacancies, managers often use term hiring in the interest of speed.

3.56 **Term employees seek indeterminate positions.** Term employees are often seeking greater job security. As soon as they are hired, term employees can compete for indeterminate positions in competitions that are open only to public servants (known as closed competitions). When they are successful, the resulting turnover causes operational problems. Managers who have hired term employees said they cannot hire on an indeterminate basis for a number of reasons, including the need to protect a position for an indeterminate employee on assignment and a lack of stable funding.

3.57 **"Try before you buy" is easier than probation.** Managers state that term hiring also allows them to "try before they buy," managing employees on the job for a period before deciding whether to make them indeterminate. Managers say that if the term employee is a poor performer or does not fit the organization well, they simply do not renew the term.

3.58 Managers we interviewed said that they avoid rejecting new indeterminate employees with performance problems in the probation period because they find the system too unwieldy and time-consuming, and the result unsatisfactory.

3.59 **Short-term funding.** One of the reasons given for the departmental and managerial focus on short-term hiring was concern about the availability of long-term funding. Responsibility to address these concerns is shared by both the government and departments.

3.60 Managers in interviews and focus groups said consistently that one of their reasons for hiring on a term basis is uncertainty about continued funding. They are unwilling to fill vacancies with indeterminate staff when they are not sure if funding will continue for the areas under their responsibility. They do not want to be in the situation of having to lay off indeterminate staff due to a lack of ongoing funding.

A broader and long-term approach to recruitment is needed

3.61 As already noted, recruitment has tended to focus more on replacing individuals and filling these vacancies than on a structured, organization-wide process to ensure that a department will have the resources it needs. Such a process would build on improved human resource planning and recruitment strategies. It would also include succession planning and analysis of existing financial flexibilities.

3.62 Succession planning is the process of actively assessing and developing the organization's ability to sustain and replenish critical talent over time. It includes both anticipating and filling key vacancies and meeting future strategic needs. As Chapter 2 notes, the public service is facing a significant "human capital" challenge due to the high levels of retirement expected over the next decade.

3.63 Line managers told us they are aware of the demographic challenges their own working units face because of impending retirements. They can identify critical circumstances they will have to deal with as experienced employees retire for whom no replacements have been trained. They noted that the demographic challenges are often even more critical in the regions, where the pools of potential replacement employees are not as evident as they are at headquarters. We found some departments further along than others in developing succession plans; the TBS is an example, and Environment Canada, for its meteorologists.

3.64 Managers told us they do not have the funds to bring in junior and mid-level people now to receive adequate training and mentoring from experienced personnel who will be leaving in a few years. They want more bridge financing to help with succession planning for key positions.

3.65 The recently approved Graduate Opportunity Strategy (GOS) for six science-based departments is designed to recruit science graduates before senior personnel leave to ensure that highly specialized knowledge is transferred. Environment Canada has been dealing with succession planning for meteorologists through a recruitment and development program that pairs new interns with experienced personnel.

3.66 In our opinion, departments have more flexibility in salary expenditures than they are using. They need to analyze historical trends in spending to show the salary dollars that lapse each year. These lapsed dollars offer an unexplored opportunity to hire additional people in areas of critical need and to break the cycle of term hiring by offering more indeterminate positions. Departments also need to focus on whether their short-term hiring provides the resources they need to meet their long-term goals and objectives.

3.67 **Recommendation.** Departments should identify where increased investment in indeterminate hiring is needed to meet their long-term human resource needs.

3.68 Following Program Review, downsizing, and budget restraints, the government undertook a further review to ensure that existing programs were adequately structured and resourced. In the second round of that review, in 2001, the Treasury Board committed a total of $89 million over five years (of a total $210 million requested) to help relieve critical pressures on recruitment, learning, and retention and to help close the government's critical policy and information gaps. The objective was to strengthen the government's capacity for responding to recruitment challenges it faces.

3.69 Funding of $23 million was provided to 12 of the 18 government-wide functional communities at risk. Of that amount, $11.9 million was directed to support secretariats for 12 functional communities to build capacity. In addition, three specific recruitment and development programs for human resource specialists, compensation specialists, and science and technology recruits would receive a total of $10.6 million to cover salary costs in this fiscal year and the costs of training and certifying procurement specialists.

3.70 Funding submissions from 15 of the functional community groups had a range of proposals. Serious shortages in the levels of staff needed to meet government objectives were cited in submissions as one consequence should many of the functional communities at risk not get adequate funding. But only eight submissions mentioned some form of overall future recruitment strategy. A few of those, such as the submissions from the human resource management community and the science and technology community, had very specific recruitment targets. The rest were very general, though, and did not link the strategy to expected demands or to demographic analyses.

3.71 Most recruitment initiatives that were approved received funds for only fiscal year 2001–02. Exceptions were initiatives of the Public Service Commission and the Canadian Centre for Management Development. Treasury Board Secretariat officials said they were taking a cautious approach and would be reviewing progress after one year to see if funds were having the intended impact. By the end of June 2001, however, departments and functional communities had not received the one-year funding.

3.72 Other funding uncertainties account for some of the short-term hiring by departments. Health Canada, Environment Canada, and Natural Resources Canada work in partnership arrangements and project-based science that receive funding from outside the government. Managers are never certain whether projects will be renewed or new projects started. Some divisions in PWGSC operate on a cost recovery basis and their funding is based on revenues earned. Budgets vary with the demand for their services.

3.73 Short-term and limited-term funding are not intended to, and do not, encourage a focus on long-term solutions. This leaves managers and departments in a dilemma. They need competent employees to complete short-term projects, but managers do not want to take the risk of offering an indeterminate position without a confirmation of long-term funding.

Managers need more inventories of candidates

3.74 The managers we interviewed said they needed more and better tools to identify candidates for recruitment. Line managers and human resource professionals told us they need more inventories of pre-qualified individuals that they can draw from quickly to meet their recruitment needs. They indicated they would like a pool of candidates who meet the selection standard for the group but are not ranked in comparison with each other. From these inventories, managers can select individuals to interview who best fit the specific requirements of the vacant position.

3.75 A few inventories across the public service already exist and operate in different ways. The Commission has maintained inventories for the information technology/information management group. Hiring managers have access to this inventory database and can use their own search criteria to make their own selection of candidates to interview. Over the past year, searches of the inventory by managers ranged from 512 to 981 a month.

3.76 The Commission recently started an inventory of experienced human resource management candidates in the National Capital Region. PSC officers develop lists of potential candidates for a department, based on the department's selection criteria.

3.77 Some departments have created their own inventories for their unique needs. Where such inventories exist, they are used. Over 20 percent of the respondents to our Internet survey said they use departmental inventories to recruit staff. Health Canada has a Canada-wide inventory of nurses. PWGSC developed a questionnaire for experienced architects and engineers, which was posted on the Commission's Web site at www.jobs.gc.ca. The Commission created a database to keep an inventory and it advertised positions in professional journals. Sixty people were recruited in this way in 2001.

3.78 In some cases, a department may create a short-term inventory of candidates for a particular group and level. Health Canada has established short-term inventories to fill shortages in specific science groups and to market employment equity referrals. For the past two years, the Treasury Board Secretariat and the Department of Finance have created a joint inventory of candidates for junior administrative positions. This allowed them to fill many vacancies quickly. They also found many qualified individuals for whom they had no positions, and they shared their inventory with the Commission for use by other departments; almost every individual was placed. In previous years, the Department of Finance also developed an effective inventory of candidates for senior-level economist positions.

3.79 The creation of such inventories in more departments and across the public service would give managers an important source of candidates. They could get information quickly on potentially available candidates and develop a short list to interview. If not enough candidates were available, they could decide to advertise vacant positions. This would significantly reduce the time that hiring managers spend filling vacancies. The Government of Quebec is using this approach, advertising to develop pools of candidates for a number of occupational areas.

3.80 **Recommendation.** Deputy heads should ensure that departments analyze their recruitment needs in order to identify where local or departmental inventories of pre-qualified candidates need to be developed and maintained.

3.81 **Recommendation.** The government should analyze its recruitment needs across the public service to identify where it needs to develop and maintain central inventories of pre-qualified candidates.

E-recruitment has had a positive impact but more is needed

3.82 Many managers we spoke with identified a need for a better electronic recruiting system. The Commission has been developing its e-recruitment Web site for a number of years to improve access to public service jobs via the Internet (www.jobs.gc.ca). Statistics show that the site has attracted a large number of visitors and a large volume of applicants for many types of jobs.

3.83 In 2000–01, more than 70 percent of the 277,910 applications received by the Commission in open competitions were made on-line. In a PSC survey of recent hires, 81 percent of those who had used the Internet in their job search had used the PSC site. Fifty-nine percent said it had been their most valuable job search avenue.

3.84 When a recruitment system is inefficient, however, automating it can generate as many problems as solutions. Electronic filing makes it easy for an individual to apply for many vacancies. While more applications may be received for a vacancy, managers have complained that many applicants do not meet even the basic requirements of the position.

3.85 Moreover, the high-tech Internet entry system is still feeding the old, low-tech, slow, paper-driven recruitment process. Managers complain that when they hold a competition they still have to spend many hours reviewing paper copies of applications from candidates who managers say clearly do not meet the requirements of the position. They want a system that will provide better initial screening of candidates, give managers electronic access to the applications, and reduce the paperburden on all concerned.

3.86 The existing government Web site does not have the features commonly associated with private sector e-recruitment. This need not be the case. Private sector recruitment systems provide additional features to deal with high volumes of applications. These new systems are designed to make the recruitment process more effective and less time-consuming for both the applicants and the hiring managers. Exhibit 3.2 compares features of private sector e-recruitment systems with the Commission's present system.

Exhibit 3.2 Comparison of private sector e-recruitment systems with the Commission's www.jobs.gc.ca

Provides applicants with the information they need to apply	Yes
Informs applicants about the status of their application and the results of the process	No
Notifies applicants of other competitions in their area of interest	Yes, if requested by applicant
Capable of handling multi-component ratings (that is, self-assessment, written test results, interview results)	No
Automatically reviews and screens applications on-line against the stated job requirements. Removes all those that do not meet the requirements, reducing the burden on the hiring manager of reviewing all applications	No
Provides for on-line testing of applicants	No
Provides detailed relevant statistics on the recruitment process and applicants, including time taken to recruit	No

3.87 The Commission did seek additional funding to upgrade its e-recruitment system but did not get all the funding it sought. It plans to pilot an e-recruitment system in a large region this year that will incorporate many of the features listed in Exhibit 3.2. It is also reviewing on-line testing and information on candidates' status for its Post-Secondary Recruitment Program.

3.88 **Recommendation.** The government should upgrade its e-recruitment system to provide better service both to managers who need personnel and to applicants.

Area of selection is being challenged

3.89 The federal public service has a presence in all parts of the country. Indeed, the government has made certain strategic decisions to locate some of its functions in the regions, in part to support local employment. Roughly 66 percent of public servants are located outside the National Capital Region.

3.90 Consistent with this strategy, the *Public Service Employment Act* says the area of selection can be limited to a geographic or organizational area. However, the government has also made commitments under the Social Union Framework Agreement and the Agreement on Internal Trade to eliminate barriers to workforce mobility.

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3.91 Unless a department has been delegated full recruitment authority, the Commission decides on the area of selection in consultation with the hiring department. The guiding principle has been to select from an area that would meet the requirements of the *Canadian Charter of Rights and Freedoms* and the social union and internal trade agreements, would yield a reasonable number of qualified candidates, and would balance affordability with efficiency.

3.92 Before the use of the Internet, the Commission would advertise on behalf of departments in the local areas where candidates were being sought. With Internet advertising, the limits on the area of selection have become more transparent and are being questioned.

3.93 We reviewed all the administrative, scientific, and professional jobs posted on www.jobs.gc.ca each day from 19 March to 1 June 2001. The total was over 1,100 jobs.

3.94 Exhibit 3.3 shows that overall, 21 percent of the jobs were advertised nationally, 62 percent were advertised in specific regions outside the National Capital Region, and 17 percent were limited to the National Capital Region. This pattern closely reflects the distribution of government positions across the country.

Exhibit 3.3 Areas of selection and types of positions advertised*

Area	All positions	Positions under $50,000	Positions over $50,000	Indeterminate positions	Term positions
National	21	1	38	33	11
Restricted to the National Capital Region	17	24	11	11	22
Restricted to other areas	62	75	51	56	67
Total	100	100	100	100	100

* All figures are percentages.

3.95 There has been some concern that certain positions with meaningful input to policy development and program delivery are limited to the National Capital Region. However, during the period and in the categories we reviewed, jobs that pay $50,000 or more and that are likely have an impact on policy or program delivery are more often open to candidates across Canada or restricted to regions outside the national capital (see again Exhibit 3.3). Similarly, indeterminate jobs at any level are more likely to be advertised in the regions or nationally than limited to the National Capital Region.

3.96 The Commission has developed a plan for the gradual implementation of a national area of selection for open competitions. As a first step, the PSC

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3.96 The Commission has developed a plan for the gradual implementation of a national area of selection for open competitions. As a first step, the PSC announced that a national area of selection would be used systematically for senior-level jobs effective 1 October 2001 in the National Capital Region and 19 November 2001 in other regions. As a result, both term and indeterminate jobs will be open to persons residing or working across Canada and to Canadians residing abroad. The plan includes a number of pilot projects, conducted in collaboration with departments, that will be assessed for the impact of the national area of selection on costs, workload, and other factors before expanding it further.

3.97 In our opinion, a national area of selection for all positions would reduce the benefits of deciding to place government functions across the country. Opening all positions across the country could have a significant impact on the affordability and efficiency of recruitment. It could increase the volume of applications and therefore the time it takes to hire someone. It could increase the costs of the selection process and of moving successful candidates to the job location.

3.98 Broadening the area of selection would require better electronic recruitment tools to manage the volume of applications it could generate. It would require a more practical process that would allow managers to decide how many candidates they need to interview.

3.99 In our opinion, without appropriate changes to recruitment systems and tools, broadening the area of selection could make the existing system even more cumbersome and thus increase the use of short-term hiring.

3.100 **Recommendation.** The government should evaluate the impact of broadening the area of selection to ensure that actions do not have a negative effect on recruitment.

Support for recruitment

Not enough support for hiring managers

3.101 We expected that central and departmental recruitment services and advice would respond both to strategic and operational requirements and to public service staffing values.

3.102 **Managers get information from a variety of sources.** When making recruitment decisions, managers can draw on assistance from human resource professionals, colleagues, and a wealth of information available in print and on the Internet.

3.103 In our Internet survey, we asked hiring managers about the usefulness of advice and information they received for their recruitment decisions (Exhibit 3.4). We found that they rely mostly on departmental information and advice. Managers who used their departments' human resource professionals were significantly more positive about the usefulness of services than those who used the Commission's advisors.

3.104 The Commission provides extensive information on recruitment, both in print and on its Web sites. It recently put a lot of effort into developing various information documents, rewriting the staffing manual, and providing

Exhibit 3.4 Usefulness of recruitment advice and information*

Source of advice or information	Managers who found it "useful" to "very useful"	Managers who found it "less than useful" to "not useful"	Managers who had not used this source
Departmental human resource personnel	84	15	1
Other line managers	77	13	10
Departmental recruitment policies	47	43	10
The Commission's Web site	43	26	31
The Commission's staffing policies and guidelines	39	36	25
Departmental Web sites	37	33	30
The Commission's *Manager's Handbook on Staffing and Recruitment*	34	23	43
The Commission's personnel	29	39	32

* All figures are percentages

training courses for line managers and human resource professionals. Some departments offer their own line managers information sessions and materials on staffing alternatives.

3.105 However, it is not clear that managers have the time or inclination to review the available information. While 43 percent of the respondents to our survey found the Commission's Web site useful to very useful, more than 31 percent had not used it at all.

3.106 The Commission has developed the *Manager's Handbook on Staffing and Recruitment* to provide hiring managers with advice and guidance. The handbook is available on the Internet and 23,000 copies have been distributed to departments and agencies, 3,000 of them to the departments we audited. However, 43 percent of the hiring managers we surveyed in these departments had not used the handbook. Many managers we interviewed were also unaware of it. Those who knew of it noted that it provides a new manager with useful information on various approaches to hiring.

Managers are unhappy with services provided by the Commission

3.107 Our interviews and focus groups showed consistently that there is considerable dissatisfaction with the services provided by the Commission. Overall, managers do not see the Commission as "value added." They often

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3.107 Our interviews and focus groups showed consistently that there is considerable dissatisfaction with the services provided by the Commission. Overall, managers do not see the Commission as "value added." They often described it as an impediment to recruitment because it focusses more on control than on providing service.

3.108 We found that the quality of support given to managers by Commission personnel varies significantly, depending on the region and the officer. When managers were positive, it was because they had developed a personal relationship with a human resource advisor from the Commission. They noted their frustration with the turnover of advisors, as this usually means they have to develop relationships again and educate new advisors about the unique nature of their departments and the types of individuals they need to recruit. They also noted that it is hard to get service when advisors they normally work with are away.

3.109 The Commission's involvement in recruitment adds to the length of the process. For individual competitions, the normal process is as follows:

- The hiring manager prepares the competition notice with the departmental human resource advisor, has it translated, and sends it to the Commission. The PSC provides advice on the statement of qualifications, area of selection, and notice period; does quality control on the advertisement and its translation; and has it posted on the Web site.
- Once it receives applications for the position, the Commission pre-screens them to ensure that each was submitted on time and from the correct geographical area for the competition, that the applicant is a Canadian citizen, and that the applicant meets the educational requirements of the job. This can take a number of days or weeks, depending on the Commission's workload and the number of applications it receives.
- Once this preliminary review is done, paper copies of the applications that pass the initial screening are sent to the hiring manager for a second review. Managers complain that they receive boxes of applications, whether they meet the minimum requirements of the position or not. They want better initial screening, especially considering how long the Commission holds on to the applications.
- The PSC may do further testing of candidates at the request of the manager to reduce the list of candidates, but this will take additional time.
- The PSC may also add candidates from its employment equity inventories. However, it does not contact these candidates to see if they are interested in the position. A hiring manager who includes one of those candidates on a short list must contact that candidate about the position.
- Once the hiring manager has identified a short list of candidates to interview, the entire package is supposed to be sent back to the Commission, which can challenge the manager's decisions. This list becomes the Commission's referral list and only then are the candidates supposed to be contacted for an interview. However, the Commission advises us that after the pre-screening, departments carry out further screening, assess and appoint candidates, and often forget to notify the Commission of the results of the process.

Levels of support by departmental human resource advisors vary

3.110 Managers first go to the departmental human resource advisors for useful information. We found that the level of support provided by departmental advisors at headquarters is quite different from that in the regions. Regional managers often made more negative comments about the services provided by human resource personnel at their departments' headquarters. Those who have spent a number of years as hiring managers talk about the need to develop a personal relationship with their human resource advisors. They note that shortages and turnovers of human resource advisors and their increased workload have had a negative impact on service.

3.111 Responses to our survey indicated that most recruiting work is done by the hiring manager and staff and not by the department's human resource personnel. Departmental human resource staff take on more responsibility for drafting the competition poster and writing the letter of offer; all intervening steps are handled primarily by the line managers and their staff. Our focus groups with hiring managers yielded similar results.

3.112 Managers told us that they had to spend a significant amount of time drafting the statement of qualifications for each vacancy. We noted that human resource advisors at Natural Resources Canada and Public Works and Government Services Canada have developed on-line tools to help hiring managers quickly develop statements of qualifications in both official languages that reflect the duties of the position. Other departments have indicated an interest in acquiring similar tools.

Human resource advisors need to really advise

3.113 In the present system, poor service from central agency and departmental human resource personnel has been attributed to a variety of factors:

- not enough operational staffing officers in the Commission to serve departments;
- not enough human resource officers in the departments because of workload and high turnover rates of those who are there;
- the risk-averse, rules-focussed approach that human resource advisors take; and
- the amount of time that human resource personnel spend processing short-term hiring transactions.

3.114 Human resource professionals in the Commission and in departments are seen more as controllers of the process than as providers of a service. They are perceived as putting up roadblocks. Managers complain that they are not trusted to take the appropriate actions to meet their recruitment needs.

3.115 As roles change, the skill sets and mindsets of human resource advisors in central agencies and in departments will also need to change. In our opinion, they need, independent of any changes to the recruiting system, a more strategic and service-oriented approach both in the departments and in the public service as a whole. They need to focus on both client needs and operational objectives, working with line managers and corporate services such as planning, finance, and information technology. While ensuring that fundamental principles are respected, they need to be oriented more toward results than process. This will require training of both new and present advisors and an eye to service and results in future recruitment of human resource professionals.

3.116 **Recommendation.** The government and departments should ensure that human resource professionals develop a more strategic and service-oriented approach to working with line managers.

Reporting on recruitment

Reporting within government on recruitment issues is poor

3.117 We expected that departments would report to central agencies the information needed to manage corporate responsibilities and to account to the Clerk of the Privy Council as Head of the Public Service.

3.118 Last year, the Clerk asked all deputy ministers to report on their progress toward the government's three human resource priorities (recruitment, retention, and learning). For the recruitment priority, they were to identify projections and plans for recruitment, including their plans to better reflect the diversity of Canadian society. A follow-up letter was sent this year to ask for results. In addition, the Treasury Board Secretariat and the Public Service Commission were to undertake certain recruitment actions under a three-year action plan and report their progress to the Committee of Senior Officials (COSO) Sub-Committee on Recruitment, chaired by the Clerk.

3.119 The goal set for the first year in the published action plan was for departments to identify their recruitment needs for the next three to five years. In fact, in the first response to the Clerk's call letter, few departments actually provided three-year recruitment plans that had specific targets, including employment equity targets. The updated responses this year were also quite general. Departments reported on activities they had undertaken but did not necessarily report against the planned action they had outlined the year before. Their letters identified a number of challenges and problems they have encountered but gave little specific data to indicate actual progress on recruitment.

3.120 Similarly, the report by the Commission and the Treasury Board Secretariat on the recruitment action plan describes actions they have taken in the first year. We agree with the report that there has been increased awareness of recruitment issues and that a start has been made to address them. Our analysis of the report is that it provides context but is activity-focussed. At this time, it is difficult to gauge overall progress or the impact of the initiatives on recruitment levels. We are also concerned that the report indicates that results both for the second and third years of the action plan cannot be achieved fully without significant new funding.

Information on recruitment can be improved

3.121 In our opinion, information on recruitment should enable managers in departments and central agencies to assess their progress to date and decide on directions for the future. Senior management needs to know about significant recruitment problems and other human resource management issues that could have an impact on the achievement of objectives.

3.122 Senior managers in departments need better information on several aspects of recruitment and human resource management, which could include the following:

- information on areas of expected staff shortages or overages and groups at risk;
- problems and opportunities associated with acquiring and retaining key staff;
- regular measurement of progress and shortfalls against departmental and central agency recruitment strategies;
- identification of the costs of various recruitment approaches;
- identification of the time it takes to recruit using the various approaches;
- assessment of the market environment (for example, numbers of graduates, in what disciplines, and the competition for talent);
- development of appropriate recruitment service standards and reporting against them; and
- information on best practices.

3.123 **Recommendation**. Deputy ministers should ensure that improvements are made in analyzing recruitment-related information and in reporting on issues, opportunities, risks, and threats.

Conclusion

3.124 We undertook this audit to examine how well the general recruitment of personnel into the public service meets both current and future requirements.

3.125 Chapter 2 notes that an alternative system of short-term hiring has evolved as managers work around the more formal hiring system. It notes that the legislative and management framework for recruitment requires radical change to ensure that a new system is more responsive to the operational needs of departments and to the long-term needs of the public service as a whole.

3.126 This chapter describes the weaknesses we found in human resource planning, recruitment practices, and recruitment services to line managers, weaknesses that further contribute to managers' focus on short-term hiring.

3.127 A more global view of human resource management is needed to break the cycle of meeting recruitment needs one job at a time. This would require departments and agencies to do more detailed analysis and reporting of recruitment information to senior management, central agencies and, where necessary, Parliament. This more global view is needed to ensure that the government will take the recruitment actions that are appropriate to address its present and emerging needs.

3.128 The public service of the 21st century needs effective recruitment tools that respond quickly and efficiently to its needs. Inventories of pre-qualified candidates and an improved e-recruitment system will help to match managers who need to fill positions with Canadians who are looking for a career in the public service.

3.129 Managers need to get more support from their human resource advisors and an increased focus on results in the services their human resource advisors provide. Human resource advisors need to be more service-oriented, focussing less on process and more on results.

3.130 The current culture of hiring on a short-term basis must change if the government is to meet the need for a strong public service in the future. Action is required to change both the system and the practices associated with recruitment.

Government's response. The government concurs with the Auditor General that the legislative and management framework for recruitment requires substantial change to ensure that new systems and practices are more responsive to both operational requirements of departments and the long-term needs of the public service.

In fact, the Prime Minister announced the creation of the Task Force on Modernizing Human Resources Management in the Public Service. Headed by Mr. Ranald Quail, the Task Force will recommend a new strategic, legislative, and institutional framework for human resources in the federal public service.

While there have been many improvements in general recruitment practices in the public service, we recognize that a great deal more progress is required, particularly in the areas of human resources planning, developing inventories of pre-qualified individuals, upgrading the government's capacity for electronic recruitment, and improving its capacity to analyze trends.

As the Prime Minister said in his reply to the Speech from the Throne, "The government will take all the steps necessary to ensure that we continue to have the talent necessary for a public service that is committed to excellence." Recruitment is critical to achieving excellence in order to maintain a first-class public service.

Public Service Commission's response. The Commission agrees with the recommendations made on general recruitment practices and the audit observations are consistent with the findings from its own studies and its Annual Report. The Commission strongly supports the view that effective human resources planning is the prerequisite to address the issue of the high level of short-term hiring. With good planning and an additional investment in people and tools, current and future human resources requirements of the public service can be met.

The Commission is Parliament's agency responsible for ensuring that new recruits are appointed to the public service on the basis of their competencies and skills. Merit finds practical meaning in the application of all the values that underlie it—competency, nonpartisanship, and representativeness—as well as in the processes that lead to appointments. This represents a unique challenge of balancing the efficiency, effectiveness, and affordability of the staffing action with the fairness, transparency, and equity of the selection process. The fact that the public service is subject to higher standards than the private sector in terms of values has been recognized in various forums, including a report entitled *A Strong Foundation: Report of the Task Force on Public Service Values and Ethics* (Tait Report). The Commission has laid the foundation for the future legislative and management framework with its staffing delegation and accountability regime and its values-based approach.

The Commission has recognized, for some time, that the recourse system was not meeting the needs of a modern staffing regime, and it has implemented rule changes and other measures such as disclosure and mediation. In 1999 the PSC asked its Advisory Committee to establish a working group of management and union representatives to study and report on recourse. In April 2001, the PSC received and endorsed the report, which addressed all issues that are raised in this document. The Commission subsequently presented the report for consideration to the Quail Task Force on Modernizing Human Resources Management in the Public Service.

About the Audit

Objectives

The objective of the audit was to examine how well the general recruitment of personnel into the public service meets both current and future requirements. The audit would identify current general recruitment practices and their accompanying opportunities and constraints.

Scope and approach

The audit focussed on the general recruitment of employees into the Scientific and Professional category and the Administrative and Foreign Service category. The audit reviewed activities in both the central agencies and a sampling of departments. The departments reviewed were Public Works and Government Services Canada, Health Canada, Natural Resources Canada, Environment Canada, the Treasury Board Secretariat, and the Department of Finance. While the primary central agency focus was on the Public Service Commission and the Treasury Board Secretariat, there was some contact with the other key players in the area of human resource management.

In addition to an extensive review of documentation and reliance on earlier work of the Office, this audit involved interviews with senior officials in the selected departments and central agencies, hiring managers, and human resource professionals. We held focus groups across Canada with hiring managers in the sample departments. We met with representatives of four regional councils to discuss recruitment. We also conducted a review of the recruitment Web site activity, recruitment practices in the public and private sectors, and a Web-based questionnaire to line managers in our sample departments.

During our audit, we conducted an Internet survey of 1,262 managers who were identified by the six departments as having hired individuals to the relevant occupational groups in the last two years. We received responses from 648 or 51 percent of this group.

We relied on recent work undertaken by the Information Management and Review Directorate of the Commission, and the Committee of Senior Officials (COSO) Sub-Committee on Recruitment. We examined staffing and recruitment practices of organizations in the wider federal public service (some Crown corporations and separate employers) that are not subject to the *Public Service Employment Act*.

Criteria

Our audit was based on the following criteria:

- Service-wide demographic analysis and human resource planning is undertaken.
- Departmental human resource planning is based on demographic analysis and integrated with departmental strategic and operational plans.
- Systems and procedures for general recruitment respond in a timely and cost-effective manner to the current and future needs of the public service.
- Central and departmental recruitment service and advice responds to both strategic and operational requirements and public service staffing values.
- Actions are taken to respond to deficiencies identified and recommendations made in previous audits, evaluations, and studies.
- There is adequate reporting to Parliament on recruitment strategies, programs, and results.

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Appendix A Occupational groups for the Scientific and Professional category and the Administrative and Foreign Service category

[illegible]		[illegible]	
AC	Actuarial science	AS	Administrative services
AG	Agriculture	CO	Commerce
AR	Architecture and town planning	CS	Computer systems administration
AU	Auditing	FI	Financial administration
BI	Biological sciences	FS	Foreign service
CH	Chemistry	IS	Information services
DE	Dentistry	OM	Organization and methods
DS	Defence scientific service	PE	Personnel administration
ES	Economics, sociology, and statistics	PG	Purchasing and supply
ED	Education	PM	Program administration
EN	Engineering and land survey	TR	Translation
FO	Forestry	WP	Welfare programs
HR	Historical research		
HE	Home economics		
LA	Law		
LS	Library science		
MA	Mathematics	MM	Management trainee is also an occupational group in this category but was excluded from any results reported as recruitment to it is done through the Post-Secondary Recruitment Program.
MD	Medicine		
MT	Meteorology		
ND	Nutrition and dietetics		
NU	Nursing		
OP	Occupational and physical therapy		
PH	Pharmacy		
PC	Physical sciences		
PS	Psychology		
SE	Scientific research		
SG	Scientific regulation/patent		
SW	Social work		
UT	University teaching		
VM	Veterinary medicine		

Source: Treasury Board Secretariat

Appendix B List of functional communities

1. Audit
2. Communications
3. Executive management
4. Finance
5. Human resources
6. Information technology
7. Legal
8. Library
9. Marketing
10. Materiel and supply management
11. Middle management
12. Policy
13. Program evaluation
14. Real property
15. Records management
16. Regulatory and inspection
17. Science and technology
18. Translation

Report of the Auditor General of Canada to the House of Commons—2001

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2001

Report of the
Auditor General of Canada
to the House of Commons

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Government-Wide Management

Chapter 5
Voted Grants and Contributions:
Program Management

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

4

Voted Grants and Contributions

Government-Wide Management

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Voted Grants and Contributions
Government-Wide Management

Main Points

4.1 The government still has a lot to do to fix the chronic problems in the way it manages grants and contributions. Our most recent audits found a government-wide control system for grants and contributions that is not yet rigorous enough to ensure the proper management of public funds. We are concerned that serious and correctable problems remain unexamined and uncorrected.

4.2 The Treasury Board Secretariat does not yet monitor departmental operations adequately, and departments often fail to exercise minimum control. Grant and contribution programs tend to be undermanaged—departments pay too little attention to their design, delivery, capacity, and performance and to the training of staff who manage them. Until the Secretariat and departments meet all of their responsibilities and manage grants and contributions rigorously, these programs will have chronic problems and run an ongoing risk of using public funds ineffectively and inefficiently.

4.3 Management practices were uneven among the programs we audited. Most programs had significant shortcomings in one area or more—program design, performance measurement, project approval, or project monitoring. In other programs, we found that departments were fixing, or had fixed, problems we reported in 1999 and 2000—indicating to us that good management is achievable, if not always achieved. The problems we found were not on the scale of those in Human Resources Development Canada (HRDC) that we reported in 2000. But they were similar to what we had found in previous years in many other grant and contribution programs.

4.4 Over the past year and a half, the Treasury Board and its Secretariat took many important steps to improve the management of grants and contributions government-wide, in particular, setting out a new and better policy framework. Five new or revised policies will impact on grants and contributions. While a good foundation is now in place, it will take several years to bring all grant and contribution programs up to the standard of the revised policy framework.

4.5 We surveyed program officers and managers in nine of the programs we audited. Many said they did not feel adequately trained to do their jobs. Many believed that they lacked the time both to assess projects properly before they recommended funding and to monitor the projects that were funded. At the same time, most were satisfied with key aspects of the design of their programs.

4.6 With its revised Policy on Transfer Payments, the government is committed to evaluating all its grant and contribution programs and approving new or revised terms and conditions before 31 March 2005. This is an opportunity for the government to determine whether each grant and contribution program is achieving value for money and should continue or whether it should be modified or even terminated.

Background and other observations

4.7 The federal government plans to spend roughly $16.3 billion through voted grants and contributions in 2001–02, and another $27.4 billion through statutory grants and contributions. Over the past year, we carried out a series of audits to answer three questions:

- Are departments managing well the voted grant and contribution programs we audited?
- Are the Treasury Board and the Treasury Board Secretariat carrying out their responsibilities for setting government policy on the management of grants and contributions and for monitoring the performance of departments?
- What are the causes of government-wide problems in the management of grants and contributions?

The programs we audited plan to spend about $1.3 billion in 2001–02. (That amount does not include planned spending by the programs our follow-up work considered.)

4.8 In 1999 the Standing Committee on Public Accounts tabled its Twenty-Fourth Report to the House of Commons, which covered our December 1998 Report, Chapter 27, Grants and Contributions: Selected Programs in Industry Canada and Canadian Heritage. The Committee recommended that this Office undertake a comprehensive audit of the management of grant and contribution programs and report our conclusions and recommendations to Parliament. The audits we are reporting this year respond to that recommendation.

The Treasury Board Secretariat has responded. The Secretariat agrees with our recommendations. Actions and plans it has under way are indicated in its response at the end of the chapter.

Introduction

4.9 For many years, our Office has reported to Parliament on our audits of grant and contribution programs. And for many years, we have reported what we consider to be serious and chronic problems in managing these programs. In our 1998 Report, we noted that our audits of grant and contribution programs had made consistent observations over the past 21 years. We said that our 1977 government-wide audit found non-compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient measuring and reporting of performance. While we would find signs of improvement in specific areas when we followed up on these audits, overall we found the same kinds of problems each time we audited grant and contribution programs.

4.10 A review of our work from 1998 to 2000 shows that we continued to find the same shortcomings in the management of grant and contribution programs. We have also found, when we returned to check, that departments have taken generally satisfactory action on the problems we had identified—indicating to us that good management is achievable, if not always achieved.

4.11 In 1999 the Standing Committee on Public Accounts tabled its Twenty-Fourth Report to the House of Commons, which covered our December 1998 Report, Chapter 27, Grants and Contributions: Selected Programs in Industry Canada and Department of Canadian Heritage. The Committee recommended that this Office undertake a comprehensive audit of the management of grant and contribution programs and report our conclusions and recommendations to Parliament. The audits we are reporting this year respond to that recommendation.

What are voted grants and contributions?

4.12 The government has many ways to pursue public policy: legislation and regulation; tax measures; provision of services, information, and advice; and transfer payments to individuals, organizations, and other levels of government. Transfer payments to individuals and organizations are generally grants or contributions. That the government does not receive goods or services directly in return for transfer payments distinguishes them from payments for contracts and procurement, among others.

4.13 Some spending through grants and contributions is statutory. Statutory expenditures are those that have continuing authority by an act of Parliament, such as old age security payments and guaranteed income supplement payments, and therefore do not require Parliament's approval each year. Other grants and contributions are voted expenditures, for which parliamentary authority must be granted through an annual appropriation act.

4.14 The government uses contributions, and sometimes grants, as financial incentives to influence the recipient's behaviour in a way that contributes to achieving policy goals. The money prompts individuals and organizations to undertake activities that are in their interest but also the government's.

These are usually activities that would be too expensive or too risky for the recipient without direct financial assistance. Properly planned and managed, contribution programs give recipients a reasonable chance of success in the funded activities without contributing more public money than the recipient needs.

4.15 Contributions differ from grants in the management requirements that general government policy imposes on departments and on the recipients. An individual or organization that meets the eligibility criteria for a grant can usually receive the payment without having to meet any further conditions. In contrast, contributions are subject to performance conditions that are specified in a contribution agreement. The recipient must show that it continues to meet the performance conditions over the life of the agreement in order to be reimbursed for specific costs. The government can audit the recipient's use of contribution payments, whereas audit is not a requirement for grants. Because grants require less accountability, they should be reserved for only situations where unconditional transfers of money are shown to be appropriate.

Spending on voted grants and contributions

4.16 The Treasury Board Secretariat advised us that for 2001–02, departments and agencies show planned spending of $43.7 billion on grants and contributions, $27.4 billion of which are grants and contributions made by Human Resources Development Canada (HRDC). The total includes both statutory and voted expenditures (Exhibit 4.1).

Exhibit 4.1 Planned spending on grants and contributions, 2001–02

($ billions)

Contributions
$1.2 (3%)
Grants
$26.2 (60%)
Contributions
$12.3 (28%)
Grants
$4.0 (9%)
■ Statutory: $27.4 (63%)
▨ Non-statutory (voted): $16.3 (37%)

Source: Treasury Board Secretariat

4.17 A total of $16.3 billion in government-wide spending on non-statutory or voted grants and contributions was planned for 2001–02. The departments spending the most are Indian and Northern Affairs Canada, Veterans Affairs Canada, Canadian International Development Agency (CIDA), and Human Resources Development Canada (see Exhibit 4.2 and the Appendix to this chapter).

Exhibit 4.2 Planned spending on voted grants and contributions, by department and agency, 2001–02

[illegible]	[illegible]	[illegible]
Indian and Northern Affairs Canada	4,338.2	26.6
Veterans Affairs Canada	1,513.8	9.3
Canadian International Development Agency	1,481.9	9.1
Human Resources Development Canada	1,062.8	6.5
Health Canada	954.6	5.9
Agriculture and Agri-Food Canada	809.4	5.0
Sub total	**10,160.7**	**62.4**
Others	6,125.1	37.6
Total	**16,285.8**	**100**

Source: 2001–02 Part II—*Main Estimates*

Managing grants and contributions—The basics

4.18 **The Board and the Secretariat.** The Treasury Board—a committee of Cabinet ministers—co-ordinates the management of government operations to ensure overall efficiency and to help departments improve their management practices. The Board is assisted by its Secretariat, public servants who develop government-wide standards for good management, provide leadership, and support the exchange of best practices among departments.

4.19 Under the *Financial Administration Act* (FAA), the Treasury Board has responsibility for establishing management policies, including financial management standards in departments. It has the statutory authority under the FAA to prescribe the way departments manage public money. For grants and contributions, it does this in two ways:

- it sets government-wide policies such as the Policy on Transfer Payments, which applies to grants and contributions; and
- it approves the terms and conditions of each grant and contribution program.

4.20 Departments and agencies are responsible for delivering programs in accordance with these terms and conditions. The Secretariat is responsible for monitoring whether departments and agencies are complying with the Treasury Board's policies and decisions, such as those on grants and contributions.

4.21 **The departments and agencies.** Departments and agencies play the key role in managing grants and contributions. They must do the following:

- design and implement effective financial and program controls in their transfer payment programs;

Exhibit 4.2 Planned spending on voted grants and contributions, by department and agency, 2001–02

Department or Agency	Spending ($ millions)	Spending (Percentage)
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4.21 **The departments and agencies.** Departments and agencies play the key role in managing grants and contributions. They must do the following:

- design and implement effective financial and program controls in their transfer payment programs;

- exercise due diligence in selecting and approving recipients of transfer payments and in managing and administering the programs;
- establish efficient and effective accounting and other procedures to ensure that payment requests comply with account verification requirements of the FAA and the Payment Requisitioning Regulations;
- maintain proper records of decisions made and results achieved;
- establish an accountability framework with appropriate measuring and reporting of results achieved with the transferred funds (including program evaluation); and
- ensure that they have the capacity to deliver and administer their transfer payment programs effectively.

4.22 Departments and agencies must follow Treasury Board policies, and they have the principal responsibility for ensuring that each grant and contribution program is managed well.

4.23 **A revised management stance.** In March 2000, the President of the Treasury Board tabled *Results for Canadians*, a document that sets out a management framework for government. In meeting its responsibilities, the Treasury Board states that it must maintain a balance between delegating decision-making authority to departments and agencies and holding them accountable for results. In *Results for Canadians*, the Treasury Board announced its operating philosophy as one of effective control through instruments that encourage initiative and creativity. This means moving toward a management regime based on leadership and values, well-defined standards, and sound risk management—with the right systems in place to ensure effective control at all times.

4.24 In this management stance, the Treasury Board has tasked the Secretariat with actively monitoring the status of controls in departments and agencies; it must be prepared to intervene when it encounters deficiencies. According to the Secretariat, a strong system of internal controls is the foundation for a government-wide monitoring framework. In *Results for Canadians*, the Board says departments and agencies have a responsibility to ensure that they have adequate management frameworks to manage resources and achieve results. They must also maintain a robust environment of internal control and be vigilant to detect early any conditions that could lead to a failure of control.

4.25 In addition, the Secretariat is responsible for monitoring the overall status of controls in departments and agencies. *Results for Canadians* indicates that this monitoring requires the Secretariat to actively and constructively engage internal audit, evaluation, and other departmental and agency managers so it can stay aware of how well their control systems are working. Through active monitoring, the Secretariat tracks the status of a department's controls and the adequacy of its expenditure management framework. *Results for Canadians* suggests that a system of early warning and awareness is critical so the Secretariat can take prompt action when it identifies unacceptable risks or vulnerabilities.

4.26 The Treasury Board expects departments and agencies to detect control failures and inform the Secretariat. If they detect a potential or an actual control failure, departments and agencies are responsible for early and effective remedial action; and they are to ensure that the Secretariat is aware of the corrective action they propose. *Results for Canadians* says the Treasury Board and the Secretariat must satisfy themselves that the proposed remedies are appropriate and that there is timely follow-through to their completion. Exhibit 4.3 presents the key responsibilities of the Treasury Board and the Treasury Board Secretariat as stated in *Results for Canadians*.

Exhibit 4.3 Key responsibilities of the Treasury Board and the Secretariat

- To act as a catalyst for change and to work with departments and agencies to develop integrated, accessible, citizen-focused service across the Government of Canada.
- To champion results-based management, linking resources to results on a whole-of government basis, and ensuring timely and accurate reporting to Parliament.
- To support responsible spending in the government's program base, including actively monitoring control system and compiling information sufficient to assess program performance and program integrity across the government.
- To ensure effective overall control through leadership in the setting of management frameworks and standards, focus on risk management, early attention to control deficiencies, and delegation of authority to departments and agencies commensurate with their capacity to manage resources and report on results.
- To develop and implement with departments and agencies a Government of Canada management agenda focused on practical improvement in areas such as comptrollership, informatics and service delivery.
- To work with departments and agencies in the continual promotion of public service values and the development of an exemplary workplace characterized by support for employee and the encouragement of initiative, trust, openness, communication and a respect for diversity.

Source: Excerpt from *Results for Canadians: A Management Framework for the Government of Canada*

Focus of the audit

This chapter includes three interrelated pieces of work.

- **A summary of audits completed in 2001.** This year, we report on audits of voted grant and contribution programs conducted in the Department of Canadian Heritage, Canada Economic Development for Quebec Regions, Atlantic Canada Opportunities Agency, Western Economic Diversification Canada, Agriculture and Agri-Food Canada, Health Canada, Environment Canada, Natural Resources Canada, Citizenship and Immigration Canada, Solicitor General Canada, and the Canadian Institutes of Health Research. We also followed up on previous audits of grant and contribution programs in five departments and agencies, including Human Resources Development Canada.
- **Survey of program staff.** We surveyed managers and officers of several programs we audited this year. We asked about day-to-day operations and other issues, such as training and guidance.

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- **Survey of program staff.** We surveyed managers and officers of several programs we audited this year. We asked about day-to-day operations and other issues, such as training and guidance.

- **Treasury Board and Secretariat roles.** We examined the role of the Treasury Board and the Secretariat in setting the rules for and monitoring departmental management of grants and contributions.

4.27 Chapter 5 discusses our audits of selected grant and contribution programs in nine departments and agencies and our follow-up work on three audits reported previously. Chapter 6 presents the results of our audit of economic development programs in the Atlantic Canada Opportunities Agency. Chapter 9 discusses our audit of the Population and Public Health Branch of Health Canada. We selected a variety of departments and agencies with relatively large grant and contribution programs so our observations on the management of the programs would be broadly supported. Our work also allowed us to consider the role of the Treasury Board and its Secretariat and to identify the causes of the chronic problems we continue to find in grant and contribution programs.

4.28 We looked at whether the programs we examined were managed according to the basic rules set by the Treasury Board and Parliament for the proper handling of public money. We used the *Financial Administration Act* (FAA), the Treasury Board's Policy on Transfer Payments, and the terms and conditions of each program as standards to assess the program's management. While the FAA deals with how expenditures in general are to be handled, the transfer payment policy spells out the rules for managing grants and contributions properly and disbursing public funds. The terms and conditions for each program set out the process for assessing requests for funding, monitoring project proposals, approving projects, and making payments. They are tailored to the specific circumstances of the program and its objectives.

4.29 Insisting on program management according to the rules, however, does not have to mean a system encumbered by red tape. Control over public money should be directly related to a project's significance, including the amount of money and the level of risk involved. More important, perhaps, the government needs to follow the specific rules it has set for itself when handling public money through any grant or contribution program.

Observations

Overview of program audits and survey

Audits of grants and contribution programs discussed in other chapters

4.30 We carried out a number of new audits this year and followed up on audits of grant and contribution programs reported in the past; that work is discussed in chapters 5, 6, and 9. We looked for the following elements of control:

- a program designed to achieve results, manage risks, and exercise due diligence in spending public funds;
- program results assessed and reported to Parliament;
- thorough and complete assessment of applications for funding, and proper approval of grants and contributions;

- monitoring of project activities and results as a basis for learning as well as accountability for performance; and
- proper handling of public money.

4.31 Though the audit results vary from one program to another, most programs have problems in one or more key areas. While we did find many good practices, in our view there is a continuing need to focus on the correctable problems in the programs included in our audit:

- Program design needed attention in most programs, in particular, to clarify the specific results expected from the spending of public money.
- Management had not yet developed risk management strategies to help deliver the programs in a cost-effective way.
- Where they existed, program evaluations were often limited in scope and did not provide a clear picture of whether programs were achieving value for money.
- Many of the programs had not been audited in more than five years.
- Parliament had received only limited information on program performance.
- Decisions to fund projects were often based on partial or perfunctory assessments of project merits.
- Financial control over disbursements needed to improve in some programs.
- Project monitoring practices ranged from satisfactory in some programs to weak in others.

4.32 We also followed up on previous audits of grant and contribution programs. In 1999 we reported on our audits of grant and contribution programs in the Industry Portfolio. This year we found that the Natural Sciences and Engineering Research Council and the Industrial Research Assistance Program have made satisfactory progress in correcting the problems those audits had found. In 1998 we reported on our audit of the Multiculturalism program at the Department of Canadian Heritage. Last year we reported that the program had shown little progress toward resolving the many problems we had found. This year, however, we are able to report that management has made significant strides forward. We also found that HRDC has made satisfactory progress in addressing the recommendations we made in our 2000 audit.

Results of our survey

4.33 We surveyed managers and officers in nine of the programs we audited (see About the Audit for a list of programs included in the survey). We asked them about the day-to-day operation and management of their programs.

- The vast majority of program staff were satisfied that the objectives, project assessment criteria, and eligibility criteria were clear enough to help them decide which projects to fund.
- A large majority agreed, or agreed more or less, that their programs were achieving the results expected of them.

- One in five were not confident or only somewhat confident that funding recipients needed federal money to carry out their projects.
- One in five did not believe they had been properly trained to carry out their responsibilities. In several programs, one in three did not feel adequately trained.
- One in four were not confident that they understood their responsibilities under the *Financial Administration Act*.
- One in four were not confident that they understood their responsibilities under the Treasury Board's Policy on Transfer Payments.
- A large majority were confident that they understood the responsibilities established by the terms and conditions of their programs.
- One in four did not have enough time to analyze project proposals as thoroughly as they believed was necessary. In two programs, the proportion was one in two.
- Two in five did not have enough time to monitor funded projects as thoroughly as they believed was necessary.

4.34 In our view, these survey results mirror the general results of our audit work. Some areas of program operations appear to be working reasonably well, while others are a concern and still others demand attention. Moreover, in our view it is particularly telling that a significant portion of program officers did not believe they had been properly trained, did not understand certain key responsibilities, or did not feel they had enough time to do their jobs as well as they should. These results help explain the weaknesses in due diligence and monitoring that our program audits found. They also point the way toward the kinds of solutions that will help improve program operations—straightforward actions involving training and program capacity that are well within the ability of departmental managers. As the revised transfer payment policy contains a number of significant changes, it will take time for all program managers and officers to be thoroughly familiar with the policy.

Role of the Treasury Board and Secretariat

4.35 We examined what the Treasury Board and the Secretariat were doing to help ensure control over the spending of public money through voted grants and contributions government-wide.

A risk-based approach is needed

4.36 We expected that the Treasury Board Secretariat, on the Board's behalf, would adopt a risk management approach in setting the rules for and monitoring the management of grants and contributions. A risk-based approach would allow the Secretariat to better identify and address both areas that need attention government-wide and individual departments and programs that need more support.

4.37 In April 2001, the Treasury Board issued its Integrated Risk Management Framework as a general management tool. The framework recommends that departments identify and mitigate areas of high risk. It also states that risk management is a continuous, proactive, and systematic process. Further, the framework recommends developing risk profiles, establishing the risk management function, applying the concept to make decisions such as setting priorities, and ensuring continuous learning by sharing lessons learned. We found that the Secretariat is in the early stages of applying the framework to the way it deals with grants and contributions. For example, it has not yet developed risk profiles, by department or by type of grant or contribution program. However, Secretariat officials told us that they view grants and contributions as risky, and they treat these programs differently from other government expenditures when reviewing submissions to the Treasury Board.

Clear and complete policy is essential

4.38 The Treasury Board approved its revised Policy on Transfer Payments in June 2000. The policy is the control framework overarching the management of grants and contributions. We examined the policy to determine whether it provides for good management control.

4.39 The revised policy is a significant improvement over the old one and is reasonably clear and comprehensive. The policy sets out the responsibilities of departments, the Treasury Board, and the Treasury Board Secretariat. It provides more direction to departments on prudent cash management practices than the previous policy and puts more emphasis on auditing and evaluating programs. The policy also brings together in one document a number of authorities that had been dispersed throughout the old policy and directives and a previous Treasury Board decision.

4.40 The revised policy is more comprehensive and has more mandatory elements than the old policy. The most notable mandatory element is the five-year "sunset" provision for grant and contribution programs—they all end in March 2005 or at their expiry date, whichever is earlier. Then departments must get Treasury Board approval to renew or replace the terms and conditions of their programs. The policy also promotes a results-based approach to designing and managing grant and contribution programs. Departments are expected to develop results-based management and accountability frameworks that provide for measuring and reporting results.

Rigorous review of terms and conditions is needed

4.41 We examined whether the Secretariat carries out an effective review of the terms and conditions proposed for grant and contribution programs. Departments make submissions to the Treasury Board, asking its approval for the programming they propose. The Secretariat's program sector analysts with portfolio responsibilities handle all submissions from the departments in their portfolios. Policy advice comes mainly from different parts of the Secretariat's comptrollership branch, which is responsible for policies governing audit, evaluation, financial management, and transfer payments. Under the Secretariat's "single window" concept, the program analysts are responsible for ensuring that submissions are complete.

4.42 The Secretariat needs knowledgeable and experienced program analysts for effective review and challenge of departmental submissions. On average, the program analysts we interviewed had less than two years of experience in the Secretariat. Two general factors also affect the Secretariat's capacity:

- Substantial corporate memory was lost as a result of Program Review.
- The turnover rate among Secretariat staff is very high.

4.43 In January 2001, policy centres in the Secretariat began to sign off formally on the adequacy of program terms and conditions proposed by departments. Before that, there was no standardized approach to review and challenge of grant and contribution submissions. While program analysts have a standard set of review questions, they are not required to ensure that the submissions answer them. Secretariat officials informed us that the policy centre addresses these review issues, and evidence suggests that review and challenge have become more consistent over the past year.

4.44 We asked departmental officials about the Secretariat's capacity and its responsiveness in reviewing their submissions. They told us that they sometimes find it hard to get the feedback they need about programs they have proposed, because of a lack of continuity and experience among analysts. Departmental officials did say, however, that under the revised policy the Secretariat's analysts have reviewed grant and contribution submissions with much more rigour. A number of departments observed that the Secretariat's policy centre for internal audit lacked enough staff to provide the needed guidance and assistance for grant and contribution submissions.

4.45 We examined 20 Treasury Board decisions on new or revised programming, representing a total of about $4.3 billion. The size of the programs varied from $500,000 to $728 million, and the duration of assistance ranged from a one-time payment to ongoing funding over 15 years. Nine of the programs, totalling $2.2 billion, involved some form of third-party delivery, which meant that an organization outside the government could decide who would ultimately get the money. Nine of the 20 decisions we examined were made before June 2000, and 11 were made after the revised policy was introduced. Our sample included programs that have made contributions to international organizations, for research and development, as economic incentives to create jobs in Canada, and to strengthen cultural industries.

4.46 In reviewing the decisions, we looked at whether the terms and conditions were consistent with key elements of control and with the revised transfer payment policy. We also examined the terms and conditions to determine whether they built in reasonable assurance that the funded projects could succeed. For example, we looked for the following control elements that, in our view, the Secretariat should consider in reviewing submissions that propose programs:

- Goals or objectives should be specific enough to guide the development of program controls, such as eligibility criteria, criteria for assessing applications for funding, and reasonable payment terms.
- Risk management needs to be an integral part of program design so that potential control failures are identified up front.

- Eligible recipients should represent the individuals or organizations best able to achieve program goals.
- Eligible expenses should be limited to specific project costs directly associated with, and necessary for, project success.
- Scheduling of payments should be consistent with achieving best value for the Crown.

4.47 Overall, although there had been a clear improvement since June 2000, we found that many program terms and conditions we examined lacked one or more of these control elements. For example, programs were approved whose objectives were very broad, whose performance criteria were unclear or not focussed on results, whose eligible expenditures had few or no restrictions, or which lacked frameworks for audit and evaluation.

4.48 **Broad objectives.** Objectives of some programs were stated in very broad terms and provided little information on what the spending would achieve. Further, they did not describe more specific results that were expected. Clear objectives and expected results are fundamental to developing risk management strategies, performance measurement, and key controls; they therefore also have an impact on the audit and evaluation frameworks at the core of the transfer payment policy.

4.49 **Broad definition of eligible expenditure.** Some terms and conditions defined a wide range of expenditures as eligible, or used ambiguous language that could include as eligible any and all expenditures incurred by the recipients. Setting a broad range for eligible expenses makes it difficult for departments to restrict recipients to a reasonable level of expenditure and to maximize the resources going to program delivery while minimizing administrative overhead costs.

4.50 **No audit and evaluation frameworks.** The revised transfer payment policy requires departments to include audit and evaluation frameworks in submissions to the Treasury Board for approval of proposed programs. In the period immediately following June 2000, when the Secretariat introduced the revised policy, the Treasury Board approved some submissions that lacked audit and evaluation frameworks on the condition that the departments provide them within a specified period.

4.51 Despite these weaknesses, we observed general improvements in the terms and conditions that were approved after the revised Policy on Transfer Payments was issued in June 2000. The most significant improvement was in the audit and evaluation frameworks. We noted that the Secretariat worked with departments to ensure that they integrated audits and evaluations in the design of their programs to make them part of the overall monitoring strategy.

4.52 **Exceptions to the policy.** The transfer payment policy requires departments to justify any request to the Treasury Board for authority to make advance payments. They have to demonstrate either that making frequent payments imposes an administrative cost that exceeds the interest the government loses by paying up front, or that spreading payments out would compromise government policy or program objectives. In addition, if the

Treasury Board does approve an exception to the cash management provision, departments must deduct from the transfer payment the amount of interest revenue foregone, unless otherwise approved by the Board.

4.53 In the sample of decisions we reviewed, there were three cases of authority to make advance payments, totalling $334 million. In each case, the submission provided little explanation of why the recipients needed funding in advance of need. Two cases involved payments to foundations; the Observations of the Auditor General on the Financial Statements of the Government of Canada for the Year Ended March 31, 2001 raised a number of general issues about the government's use of foundations.

Departments need more support

4.54 We found that the Secretariat has been slow to support departments in their application of the revised Policy on Transfer Payments.

4.55 The Secretariat released an information bulletin in March 2001 to clarify certain provisions of the June 2000 revised policy. However, by June 2001 it had not yet finalized its planned guide on grants and contributions. After we completed our work, Secretariat officials told us that a draft guide had been distributed to all departments. The Secretariat also advised us that it has provided training and information sessions to departments on request, and it provides other ongoing assistance.

4.56 Officials in some departments suggested to us that departments do not have an effective method of verifying whether applicants are receiving funds from other federal sources. There is no central database of recipients who receive federal funding. In June 2000, the Standing Committee on Human Resources Development and the Status of Persons with Disabilities asked the Secretariat to look into the possibility of developing this database. The Secretariat told us that it is currently examining the feasibility of doing this under the Government On-Line initiative.

Little monitoring of control by departments

4.57 We found that the Secretariat has little information on departmental operations to assess the integrity and performance of grant and contribution programs. It only recently began to act on its March 2000 commitment in *Results for Canadians* to actively monitor departmental control systems.

4.58 In February 2000, the Secretariat took an important step in assessing grants and contributions across departments. The Secretary of the Treasury Board issued a call letter to 14 departments asking them to assess their grant and contribution programs and the soundness of their financial and management practices. The departments provided information on the scope of their programs and a "snapshot" of the audit and evaluation work they had under way. The Secretariat did not use the information to develop risk profiles of each department.

4.59 **The newly issued policy on active monitoring.** The Treasury Board issued its policy on active monitoring in June 2001. The policy calls for the Secretariat to monitor for early signs of control problems in departments. It places the onus on departments to determine when to notify the Secretariat about management issues that could become "significant concerns."

4.60 The policy is not aimed specifically at grant and contribution programs—it applies to all aspects of departmental operations. The Treasury Board approved $7.5 million for the Secretariat to implement the policy over the next three years. At the end of our audit, the Secretariat had just started to implement it and it was too early for us to assess the impact.

4.61 **Newly revised internal audit and evaluation policies.** A Secretariat study in January 2000 suggested that internal audit and evaluation in departments had eroded significantly as a result of Program Review. The number of internal auditors declined from about 590 in 1995 to fewer than 300 in 1999. At the time of our audit, the Secretariat was allocating $28 million to departments and small agencies for the next two years. The Board expects that the additional resources will restore internal audit and evaluation capacity in departments and policy capacity in the Secretariat.

4.62 In April 2001, the Treasury Board issued revised policies on internal audit and evaluation, in line with the revised transfer payment policy. While these measures are significant steps in the right direction, at the time of our audit it was too early to determine whether the revised policies have materially improved the management of grants and contributions. In our view, departments need adequately resourced and well-managed internal audit and evaluation functions if management and the Secretariat are to monitor departmental control systems.

4.63 **Secretariat may not be prepared for grant and contribution workload.** Under the transfer payment policy, existing terms and conditions of all grant and contribution programs will expire no later than March 2005; before that date, departments must seek the Treasury Board's approval to replace or revise terms and conditions. However, the Secretariat does not yet have an accurate count of programs coming up for renewal each year. It has not identified the resources it will need to review the revised terms and conditions and the supporting program audits and evaluations.

Little information on systemic problems

4.64 We expected that the Treasury Board Secretariat would have a process to identify systemic problems in the management of grant and contribution programs across government, would take appropriate remedial action, and would assess the effectiveness of that action. To do that, it would need a complete and accurate baseline of information on how grant and contribution programs were performing in departments.

4.65 The Secretariat informed us that it recently started the exercise of identifying and addressing systemic problems in the management of grants and contributions government-wide. It advised us that it has established portfolio teams to monitor horizontal issues, including grants and contributions. As well, it is starting to track the results of departmental audits and evaluations. Nevertheless, it will take some time for the Secretariat to develop a government-wide view of the management of grants and contributions.

4.66 We acknowledge that in revising the Policy on Transfer Payments and other related policies, the Secretariat has made significant progress toward improving the management of grants and contributions. Nevertheless, it now needs to turn its attention to identifying systemic problems across departments to ensure that programs meet the objectives of the policy. It has not yet developed specific plans for doing so.

4.67 **Little information on implementation of revised policy across government.** The Secretariat has cited the transfer payment policy as one of five financial management policies that require immediate, ongoing monitoring. When the government announced the revised policy, it said departments would review their regimes for managing transfer payments to ensure that they reflect all aspects of the policy. The Secretariat has not yet followed up with departments to learn the results of their reviews.

4.68 Nevertheless, departmental officials told us they believe the revised transfer payment policy has had a significant impact on the way they manage grants and contributions; their administrative practices have become much more rigorous. From what we have observed in our program audits, the Secretariat has made good efforts to foster public sector values and awareness of value for money in departments.

Conclusion and Recommendations

4.69 There continue to be chronic problems across the government in controlling the spending of public money through grants and contributions. There are several reasons why.

Revisions to the policy framework will take years to implement

4.70 The responsibilities of the Treasury Board lie at the centre of ensuring effective control across government over the spending of public money through grants and contributions. The Board sets the overarching policy framework for all grant and contribution programs and it approves the specific terms and conditions of each program.

4.71 The Treasury Board recently provided departments with a comprehensive and clear policy framework for managing grants and contributions. In particular, the June 2000 revisions to the Policy on Transfer Payments were a significant step forward. That said, however, public money is still being spent under program terms and conditions that may have been approved a decade or more ago. It will take several years to bring all of these terms and conditions up to the standards of the revised policy.

The Secretariat is not yet supporting the Board and departments adequately

4.72 Since 2000, the Secretariat has taken several steps to improve its support to the Board in managing grant and contribution programs government-wide. And, in our view, it is on the right track. However, at the end of our audit the Secretariat was not yet fully meeting its responsibilities for helping to ensure that grant and contribution programs are managed well across the government. So far it has little information on departmental performance or control systems for grant and contribution programs, or on progress in implementing the new policy framework. It has not yet adopted a risk management approach in its own work on grants and contributions, and it has been slow to provide the promised guide on managing these kinds of programs.

Correctable problems persist at the program level

4.73 We continue to find significant problems in the management of grants and contributions in departments. And departments have the principal responsibility for ensuring that these programs are managed well. While our audits yielded various results, almost all the programs had one or more significant problems. At the same time, we found many areas where program managers and staff have met the standards set by the government.

4.74 We surveyed program officers and managers in nine of the programs we audited. A significant proportion of them said they did not feel adequately trained to do their jobs. Many believed they lacked time to assess projects properly before they recommended funding and to monitor the projects that were funded. The survey indicated that management needs to do a much better job of training program staff and making sure they have the means to carry out their responsibilities properly.

4.75 Despite the recent changes in government policy, three elements remain underdeveloped in practice: results, risks, and the relationship between them. Contributions are designed by their very nature to reduce the costs and therefore the risks to funding recipients as they carry out projects that serve their goals as well as those of the government. Consequently, good management of contributions (and of grants that are used in the same way) has at its foundation a clear expectation of results and a good assessment of associated risks. This is the basis for deciding on the nature and extent of government support for an activity and knowing whether the activity is likely to meet the goals of the program. Although we found aspects of this approach being used in practice, the risk/results relationship is still often absent from program design and operations. Having said that, recent changes to government policy currently being implemented focus rightly on results and risks. Nevertheless, as we have noted, it will take some time for these changes to be implemented government-wide.

Grants and contributions in context

4.76 In our view, the weaknesses we have found government-wide and in departments go a long way toward explaining why problems in managing grants and contributions are so persistent. However, another part of the explanation lies in the context surrounding these programs and in other factors that have further weakened the control framework. These factors, together with the chronic problems of grant and contribution programs, greatly increase the risk of serious control failures such as those we reported in Human Resources Development Canada last year. These matters were fully explored in *Reflections on a Decade of Serving Parliament* (Report of the Auditor General of Canada to the House of Commons, February 2001).

4.77 **Failure to manage for and by results.** Managing for results has yet to gain a firm foothold in the federal government. This is a particularly significant problem for grant and contribution programs, where the government works through recipients of funding to achieve its goals. Clarity about the results expected from payments to recipients is critical to good program design and management.

4.78 **Poor reporting to Parliament on performance.** Given the slow progress in departments toward managing for results, it is no surprise that Parliament is still not informed enough about the results of government programs. This key link in the accountability chain is weak, and Parliament's ability to scrutinize departmental operations is limited.

4.79 **Cutbacks increased the stress level in the public service.** The exodus of top-calibre, experienced employees has left the public service with skill shortages, and a heavier workload for those who remained. In our view, these general factors collided and combined with long-standing problems in grant and contribution programs to create a situation where control failures were more likely. Moreover, resolving the chronic problems depends in part on progress toward resolving these broader matters of good federal public administration.

4.80 **Make the system work the way it is supposed to.** We conducted our audit using the authorities and control framework that the government has set for itself. We have found that in many important ways, the management of grants and contributions government-wide still does not meet these standards of good public administration.

4.81 **Recommendation.** The Treasury Board Secretariat should do the following:

- quickly adopt a risk management approach to its responsibilities for grants and contributions;
- accelerate its efforts to compile enough information on departmental operations to use as a basis for assessing the performance and integrity of grant and contribution programs and taking appropriate action;
- assess before the end of 2003 whether the revised Policy on Transfer Payments is meeting its objectives;
- accelerate its efforts to identify systemic control problems in grant and contribution spending, take appropriate corrective action, and assess the effectiveness of that action;
- accelerate its efforts to provide departments with appropriate direction and guidance on managing grants and contributions;
- review and challenge the terms and conditions of proposed grant and contribution programs to ensure that expected results and anticipated risks and related controls have been thoroughly developed by departments; and

- ensure that departments include in their reports on plans and priorities complete and meaningful results expected of each grant and contribution program over $5 million, and in their performance reports the actual results of each of these programs.

4.82 **Taking advantage of the next four years.** In introducing the revised Policy on Transfer Payments, the government committed to having all of its grant and contribution programs evaluated and new terms and conditions approved before 31 March 2005. This policy requirement provides an opportunity for the government to determine whether each grant and contribution program is achieving value for money and therefore whether it should continue.

4.83 **Recommendation.** Departments should report the results of their reviews to Parliament program by program. In particular, they should report on whether each program is achieving value for money and should provide the rationale for continuing it.

4.84 **Recommendation.** Departments should ensure, in collaboration with the Treasury Board Secretariat, that program staff are properly trained to carry out their responsibilities under the *Financial Administration Act* and the Policy on Transfer Payments.

Treasury Board Secretariat's response. The Treasury Board Secretariat agrees with the recommendations of the Auditor General. The recommendations reflect work already under way within the Secretariat to strengthen the government-wide management of grants and contributions.

The revised Policy on Transfer Payments, released in June 2000, has strengthened the previous management framework and requires departments to review, renew, and evaluate all grant and contribution programs. The requirements of the policy for clear objectives, strong controls, results-based accountability frameworks, and risk-based audit frameworks provide better assurance that programs are diligently managed, measured, and reported. To assist in the implementation of this new policy, a Guide to Grants and Contributions was issued and numerous training and information sessions have been held.

The Secretariat has further strengthened the management framework with four additional policies: the Integrated Risk-Management Framework, the revised Policy on Internal Audit, the Policy on Evaluation, and the Active Monitoring Policy. The Policy on Transfer Payments and its companion Guide integrate key requirements from each of these policies to provide a comprehensive framework for long-term improvement in the management of grants and contributions.

To help fulfil its role as Management Board, the Secretariat has developed a risk assessment for each of its policy instruments and is developing plans to manage and monitor the policies based on these assessments. In some areas, plans have already been implemented. For instance, Secretariat officials review all proposed grant and contribution terms and conditions and work with departments to ensure that each program fully meets the requirements of the Policy on Transfer Payments. In addition, the results of departmental audits and evaluations are proactively monitored to ensure that departments have implemented effective management control frameworks and to identify systemic problems requiring follow-up. Further, the Secretariat has maintained open communication with departments through an interdepartmental advisory committee to address areas of concern and to ensure consistent application of the Policy on Transfer Payments.

With a comprehensive management framework established, the Secretariat is now developing plans to assess the effectiveness of the policy and any requirement for further improvements that will help departments to continue to move forward on a sustained basis with the sound management of their grant and contribution programs.

4.85 Chapters 5, 6, and 9 contain a number of recommendations directed specifically at the departments our Office audited.

About the Audit

Objectives

Our audit objectives were to determine the following:

- whether the Treasury Board and the Treasury Board Secretariat have ensured effective government-wide control over the spending of public money through voted grants and contributions; and
- the causes of government-wide control problems, if any, and the progress the Board and the Secretariat have made in addressing them.

Scope and approach

We examined a sample of 20 Treasury Board submissions and decisions from April 1999 to May 2001. We conducted interviews with officials in the Secretariat. We also interviewed officials in departments.

We surveyed managers and officers of nine of the programs we audited:

- Agri-Food Trade Program—Agriculture and Agri-Food Canada
- Support for Official-Language Communities—Department of Canadian Heritage
- Language Instruction for Newcomers—Citizenship and Immigration Canada
- First Nations Policing Program—Solicitor General Canada
- Community Futures Program—Western Economic Diversification Canada
- IDEA-SME Program—Canada Economic Development for Quebec Regions
- Canada Prenatal Nutrition Program—Health Canada
- HIV/AIDS strategy—Health Canada
- Population Health Fund—Health Canada

Criteria

We expected that the Treasury Board would do the following:

- set complete and clear policy for departments to follow in managing grants and contributions; and
- ensure that the terms and conditions of approved grant and contribution programs provide for effective control.

We expected that the Secretariat would do the following:

- review and challenge the terms and conditions of proposed grant and contribution programs;
- use a risk management approach to its responsibilities for grants and contributions;
- provide appropriate direction and guidance to departments on managing grants and contributions;
- compile sufficient information on departmental operations to assess grant and contribution program performance and integrity, and take action as appropriate;
- identify systemic problems in controlling grant and contribution spending, take appropriate remedial action, and assess the effectiveness of that action; and
- reinforce public sector values and value for money attitudes among departments.

Audit team

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Appendix Planned government-wide spending on voted grants and contributions, 2001–02

[illegible]	[illegible]	[illegible]
Indian and Northern Affairs Canada	4,338.2	Economic development, education and social development, capital facilities and maintenance, administration
Veterans Affairs Canada	1,513.8	Pensions for disability and death, extended health care costs not covered by provincial health programs
Canadian International Development Agency	1,481.9	Development assistance, programs against hunger and malnutrition, humanitarian assistance
Human Resources Development Canada	1,062.8	Training and/or work experience, adults with disabilities, prevention of homelessness, child care initiatives
Health Canada	954.6	Aboriginal health services, provision of health services for young children at risk, health promotion projects, Health Infrastructure Partnership Program, health research, Canadian Strategy on HIV/AIDS
Agriculture and Agri-Food Canada	809.4	Economic development, market access and development
Department of Canadian Heritage	797.2	Promotion of official languages; assistance to book publishing industry, Canadian periodical publishers, and magazine publishing industry; Canadian Television Fund; Aboriginal friendship centres
Industry Canada	703.4	Industry sector development including technological innovation, research and development, job creation
Natural Sciences and Engineering Research Council of Canada	575.5	Support of research and scholarship
Canadian Institutes of Health Research	408.9	Creation and exchange of new health knowledge
National Defence	402.1	Civil emergency preparedness, support to NATO
Department of Foreign Affairs and International Trade	393.4	International security and co-operation, international business development, export market development
Department of Justice	373.2	Youth justice services, legal aid systems, initiatives for safer communities
Citizenship and Immigration Canada	336.5	Integration of newcomers, language instruction, resettlement assistance
Department of Finance	326.0	Multilateral debt reduction
Atlantic Canada Opportunities Agency	277.1	Regional economic development
Canada Economic Development for Quebec Regions	273.4	Infrastructure Program, Regional Strategic Initiative Program, innovation, entrepreneurship
Western Economic Diversification Canada	223.4	Business development, infrastructure works in Western Canada
Transport Canada	203.5	Airport Capital Assistance Program, TransCanada Highway Agreement–Newfoundland, ferry services, grain transportation

Department/Agency	Spending ($ millions)	Purpose
Social Sciences and Humanities Research Council of Canada	146.9	Support of research and scholarship
National Research Council Canada	133.6	Support for research; developing, adopting and exploring technology; TRIUMF project
Canada Customs and Revenue Agency	110.3	Joint administration costs of federal and provincial sales taxes
Natural Resources Canada	110.2	Hibernia Interest Assistance, support for research and development, Climate Change Action Fund
Fisheries and Oceans	80.6	Increasing Native participation in commercial fisheries, Fisheries Access Program, support to Great Lakes Water Level Emergency Response, research and development
Environment Canada	70.2	Support for Clean Environment initiatives, support for environmental and sustainable development projects, environmental clean-up
Solicitor General Canada	61.8	Policing for First Nations and Inuit communities
Canadian Space Agency	50.0	Space knowledge, applications, and industry development
Other departments and agencies	67.9	
Total	**16,285.8**	

Source: 2001–02 Part II—*Main Estimates*

[illegible]	[illegible]	[illegible]
Social Sciences and Humanities Research Council of Canada	146.9	Support of research and scholarship
National Research Council Canada	133.6	Support for research; developing, adopting and exploring technology; TRIUMF project
Canada Customs and Revenue Agency	110.3	Joint administration costs of federal and provincial sales taxes
Natural Resources Canada	110.2	Hibernia Interest Assistance, support for research and development, Climate Change Action Fund
Fisheries and Oceans	80.6	Increasing Native participation in commercial fisheries, Fisheries Access Program, support to Great Lakes Water Level Emergency Response, research and development
Environment Canada	70.2	Support for Clean Environment initiatives, support for environmental and sustainable development projects, environmental clean-up
Solicitor General Canada	61.8	Policing for First Nations and Inuit communities
Canadian Space Agency	50.0	Space knowledge, applications, and industry development
Other departments and agencies	67.9	
[illegible]	[illegible]	

Source: 2001–02 Part II—*Main Estimates*

Chapter

5

Voted Grants and Contributions

Program Management

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Voted Grants and Contributions
Program Management

Main Points

5.1 We carried out audits of a number of grant and contribution programs in several departments and agencies over the past year. We found that management practices were uneven among these programs. While audit results varied to some extent, all the programs were experiencing problems in one or more areas of management responsibility—program design, performance measurement, project assessment, and project monitoring.

Program management issues

- Program design needs attention in most programs, in particular, the specific results expected from the spending of public money.
- Management has not yet developed risk management strategies to help deliver programs in a cost-effective way.
- Where they have been carried out, program evaluations are often limited in scope and do not provide a clear overview of whether the programs are achieving value for money.
- Many programs have not been audited in more than five years.
- Parliament, despite changes to the reporting requirements, still receives limited information on program performance.

Project management issues

- Decisions to fund projects are often based on partial or perfunctory assessments of project merits and the need for government funding.
- Financial control over disbursements of public funds was generally satisfactory, although specific improvements are needed in some programs.
- Project monitoring practices ranged from satisfactory in some programs to poor in others.

5.2 We followed up on three audits of grant and contribution programs we had reported previously, including our work in Human Resources Development Canada in 2000. By and large, management has made satisfactory progress in fixing the problems we had found—indicating that good management is achievable, if not always achieved.

Background

5.3 In this chapter, we report the results of our audits of 12 grant and contribution programs in nine departments and agencies and our follow-up of three audits previously reported. We looked for key control elements—rigorous program design, relevant performance measurement and reporting, thorough project assessments, and appropriate project monitoring and financial management.

The departments have responded. The departments we audited have indicated their agreement with our recommendations. The actions they have taken or plan to take are set out in their responses to the recommendations in the respective sections of the chapter.

Introduction

5.4 This chapter discusses our audits of voted grant and contribution programs managed by nine departments and agencies and our follow-up of other audits reported previously. We wanted our work to cover a number of departments and agencies with relatively large grant and contribution programs to determine how well these programs are managed across government. That coverage would also allow us to consider more effectively the important role of the Treasury Board and its Secretariat in encouraging and ensuring good program design and management practices. Our observations on their role are set out in Chapter 4.

5.5 We tried to select programs for audit that would capture as many key features of grants and contributions as possible. These features include the type of recipient, delivery mechanism, duration of funding, policy area, size of department, sharing of cost, and funding mechanism—grant, contribution, or both. We chose the following programs:

- Agri-Food Trade Program—Agriculture and Agri-Food Canada
- IDEA-SME Program and Regional Strategic Initiatives—Canada Economic Development for Quebec Regions
- Operating Grants Program—Canadian Institutes of Health Research
- Settlement Contribution Programs—Citizenship and Immigration Canada
- Support for Official Language Communities—Department of Canadian Heritage
- Contributions made under the Climate Change Action Fund—Environment Canada and Natural Resources Canada
- First Nations Policing Program—Solicitor General Canada
- Community Futures Program—Western Economic Diversification Canada

5.6 We also followed up on previous audits of grants and contributions:

- Department of Canadian Heritage—Grants and Contributions Under the Multiculturalism Program (Chapter 27, 1998).
- Industry Portfolio: Investing In Innovation (Chapter 19, 1999)
- Human Resources Development Canada—Grants and Contributions (Chapter 11, 2000)

Focus of the audits

5.7 The objective of our detailed audits was to determine whether departments had adequate control over selected grant and contribution programs.

5.8 We looked at whether the programs we examined were managed according to basic rules set by the Treasury Board and Parliament for the proper handling of public money. We used the *Financial Administration Act* (FAA), the Treasury Board's Policy on Transfer Payments, and the terms and conditions for each program as standards to assess the program's management.

5.9 While the FAA deals with how disbursements in general are to be handled, the transfer payment policy spells out the government's rules for managing grants and contributions properly and for disbursing public funds. The terms and conditions for each program set out the process for assessing project proposals, approving projects and making payments. They are tailored to the specific circumstances of the program and its objectives.

5.10 Insisting on program management according to the rules, however, does not have to mean a system encumbered by red tape. Control over public money should be directly related to a project's significance, including the amount of money and the level of risk involved. More important, perhaps, the government needs to follow its own rules when handling public money.

5.11 The objective in our follow-up of previous recommendations was to determine what departments have done to implement corrective action. Unless otherwise stated, a follow-up is not a second audit of the same issues. It is a report on the corrective action that management tells us or can demonstrate it has taken on the recommendations of our previous audit. We do not exhaustively seek new evidence to support or refute what management tells us, but we do review its claims for reasonableness and report to Parliament accordingly.

5.12 Further details on the audits can be found in About the Audits at the end of the chapter.

Overview of Our Observations and Conclusions

5.13 In this section, we look across our audits of the programs to make observations on the major elements of program management. We do not identify individual programs in this overview; we discuss the key management responsibilities and the practices that are still weak. Our detailed observations on each program are in the rest of the chapter and take into account their specific circumstances. It is important to recognize how the programs differ and how the differences affect the way departments and agencies manage them.

5.14 We looked for rigorous program design, thorough support for decisions to spend public funds, proper control of disbursements, and good knowledge of performance. While the audit results vary among programs, all the programs have problems in one or more of these key areas. Although we found areas in each program that were managed properly, we are concerned that some public funds have been put at risk because management, in one way or another, is not always following the rules established by the government for grant and contribution programs. Where expected results are stated only vaguely, where risks are unassessed, project assessments incomplete, or performance unmeasured, management cannot be confident that the programs are achieving value for money. Moreover, the kinds of problems we found are correctable with proper attention from management, and during our program audits, management began addressing many of the issues we raised.

5.15 **Program design needs more attention in many programs.** We found that many programs set out the program objectives—the general purposes—reasonably clearly. However, they often do not set out the specific results expected from program spending within a given period of time. Most of the programs lacked a risk management strategy to help deliver the program cost-effectively. While there were various guidelines and procedures for managing specific risks when approving and monitoring projects, risk assessment has not been integrated into program management practices in a formal and systematic way. Moreover, the lack of clearly stated expected results of program spending makes it difficult for management to assess risks thoroughly and therefore to establish appropriate controls.

5.16 **No evaluation or incomplete evaluation of programs.** Assessing program performance is still a challenge for most departments. Six of the programs we audited have never been evaluated, although they have operated for many years. Two of the six other programs underwent a recent evaluation that looked at all relevant performance issues. The rest have been evaluated and the results were largely positive, but in our view the evaluations did not address all of the key aspects of performance. As a result, the evaluations yielded limited information on program performance and provided an incomplete picture of whether the programs were achieving value for money.

5.17 **Insufficient internal audit.** Three of the programs we audited for this chapter underwent an internal audit in the last five years; nine did not. As a result, management of those nine programs had little of the kind of independent information internal audit can provide on whether financial and other controls were working properly.

5.18 **Limited performance information to Parliament.** Given the limited information available on program performance, we were not surprised that Parliament is not well informed about the results of these programs. Reports to Parliament provided limited or fragmented information, or none at all, on the results of many programs we audited.

5.19 **Assessment of projects often incomplete.** Program terms and conditions set out the process that must be followed in assessing and approving applications for grants and contributions. We often could not assure ourselves in many projects we looked at that assessments had covered all the criteria in the terms and conditions or were thorough enough. Decisions to approve funding were often not supported by a careful assessment of a project's merits or the applicant's need for program funding.

5.20 **Financial control can be improved in some programs.** Generally, we found that payments meet the requirements of the *Financial Administration Act* (FAA) and the terms and conditions of the respective programs. However, some programs need to do better at managing payments in advance of need and ensuring that only eligible costs are reimbursed.

5.21 **Uneven project monitoring.** Project monitoring practices were uneven among these programs. In some programs, management had sufficient ongoing knowledge of project performance, but in others we found that monitoring was inadequate and management thus had only limited opportunity to intervene if there were problems.

5.22 **Follow-up shows satisfactory progress.** Our follow-up work on previously reported audits of grant and contribution programs found satisfactory progress on almost all the recommendations we had made. For the most part, the recommendations were directed at problems similar to those we found in this year's audits. This suggests to us that management can and does fix its practices when required to do so.

Agriculture and Agri-Food Canada—Agri-Food Trade Program

In brief

The Agri-Food Trade Program is a cost-shared contribution program designed to support the Canadian agri-food industry in a wide range of market development, investment, and trade-related activities. We audited about $26 million spent by the program in 1999–2000 and 2000–01.

We found that management has adequate financial control over program spending as well as adequate project monitoring and has taken some initiatives to manage risks. Management informs us that it has begun establishing clear expected results for the program. While management collects information on the results of individual projects, that information is not compiled and used to assess and report on program performance.
We found that projects were assessed thoroughly against most of the required criteria. However, we could not assure ourselves that the recipients' capacity to carry out the projects or their need for funding had been adequately considered.

Background

5.23 The objective of the Agri-Food Trade Program (AFTP) is to maintain or increase sales of agriculture, food, and beverage products in the domestic and foreign markets and thereby help maintain or increase investment and employment in the industry in Canada.

5.24 The program targets agriculture and food producers, processors, and exporters who work together through non-profit associations or who organize into alliances and institutions that work with the agri-food industry. The program gives priority to projects that are part of a long-term strategy for industry exports, implemented through agri-food industry associations or alliances and through participation in the Agri-Food Industry Market Strategies, a component of the AFTP.

5.25 The program is administered by the Market and Industry Services Branch of Agriculture and Agri-Food Canada. It is overseen by a small secretariat, and individual projects are managed by officers drawn from the operational directorates of the Branch. The program spent $13 million in each of the two fiscal years we audited, 1999–2000 and 2000–01.

Focus of the audit

5.26 Our audit covered the last fiscal year of the Agri-Food Trade Program 2000 (1999–2000) and the first year of the successor Agri-Food Trade Program (2000–01) that began in April 2000 and expires in March 2005.

5.27 The objective of the audit was to determine whether the Department had adequate control over the program. Further details on the audit can be found in About the Audits at the end of the chapter.

Observations and Recommendations

Program design

5.28 **Program objectives.** We expected that the program would be designed to achieve results, manage risks, ensure due diligence in spending, and provide accountability for funds spent. We found that the program's objectives are stated in very general terms: to increase sales of Canadian agriculture, food, and beverage products in domestic and foreign markets. This is consistent with the Department's support for industry's goals of increasing Canada's world-market share of agri-food product exports to 4 percent and reversing the ratio of primary products to value-added products from 60/40 to 40/60. However, the specific contribution expected from the Agri-Food Trade Program in achieving these objectives has not been determined by management. Management informed us that it has started to establish clear expected results and the means to report on them.

5.29 **Program management.** To be eligible, projects must

- have potential to significantly impact the sales of Canadian agriculture, food, and beverage products in national and international markets
- be part of the long-term strategies for the industry, implemented through agri-food industry associations or alliances that represent a significant portion of the national production of a given commodity or value-added product
- meet federal and/or provincial environmental assessment requirements.

Applicants must have the capability to complete the projects and must demonstrate that they have, or will have, adequate financial resources to discharge their obligations under the contribution agreements.

5.30 We found that program management has developed clear administrative guidelines for project officers in reviewing applications, except with respect to the need for funding.

5.31 **There is no formal risk management strategy.** Risk management is meant to strengthen management practices, decision making, and priority setting. A risk management strategy helps in identifying, analyzing, assessing, monitoring, and controlling risks in managing contributions. It helps to prevent unsatisfactory or unintended outcomes. Although the program has no formal risk management strategy in its design, we found that management has taken a number of specific initiatives that have helped to manage risks. We also found that there was evidence of co-ordination with other federal export marketing programs.

5.32 In March 2000, management reviewed the program to assess whether it had adequate measures to ensure that funding recipients were accountable for their spending. It also examined the process for submitting, reviewing, and approving applications; the payment process; project monitoring and post-project evaluation; and other key matters. In addition, management has introduced procedures to minimize risks in the processing of claims—for example, a requirement for independent audits before claims are paid and a 10 percent holdback on payment of final claims until final project reports are received.

5.33 **Recommendation.** The Department should specify clearly the results it expects from the Agri-Food Trade Program. It should also develop a formal risk assessment and management strategy for the program's operations.

Department's response. The Department partially agrees with the first part of the recommendation. The Agri-Food Trade Program objectives are to maintain or increase sales of agriculture, food, and beverage products in the domestic and foreign markets and thereby help maintain or increase investment and employment in the industry in Canada. The five performance measurement indicators currently used are sales, value-added sales, awareness of Canadian products, investment, and the creation of jobs in Canada. The Department acknowledges the need to further articulate the expected program outcomes and intends to clarify these expected results in future program reporting.

The Department agrees with the second part of the recommendation. It currently has a number of provisions in place to manage the level of risk associated with the AFTP. For instance, the program generally reimburses to a maximum of 50 percent of expenses incurred and paid by recipients (according to the terms of a legal agreement); requires external audits on all projects funded; requires a 10 percent "holdback" until the final external audit and performance reports are submitted; and conducts a regular analysis of spending trends to ensure proper management of funds. With the exception of payments of a small number of advances, most other risks have been considered and are covered in the AFTP's legal agreement. However, the Department intends to develop a formal risk assessment and management strategy for the program's operations prior to the renewal of the program's terms and conditions in 2005.

Program performance

5.34 **There has been limited program evaluation.** We expected that management would know whether the program is meeting its objectives. The Treasury Board Secretariat has established guidelines for periodic program evaluation, normally every five years, to assess program performance. Program evaluation encourages efficiency and effectiveness in program spending, and accountability for funds spent.

5.35 To date, the Department has not evaluated the Agri-Food Trade Program in a comprehensive way. A 1998 evaluation of one program element, company brand promotion, looked at its relevance and success but did not compare it with alternatives to the program. There was a heavy reliance on non-quantitative approaches to evaluating success, such as interviews. Nevertheless, the evaluation concluded that this element of the program was successful in helping Canadian industry deal with competitors in foreign markets. We also noted that the program has not been the subject of an internal audit.

5.36 **Performance information to Parliament needs to be improved.** Under the revised Treasury Board Policy on Transfer Payments, effective June 2000, the specific results planned for grant and contribution programs over $5 million must be stated clearly in a department's report on plans and priorities. We noted that Agriculture and Agri-Food Canada's 2001–02 report did not mention the specific results expected from the Agri-Food Trade Program.

5.37 There is limited information on the program's performance in the Department's 1999–2000 *Performance Report*—only the number of projects approved that year. There is a reference at the departmental level to an increase in exports of processed products (from 48 to 52 percent). There is no mention of an increase in exports directly related to this program. Nor is information provided that aggregates the results of individual projects funded under the program.

5.38 **Recommendation.** The Department should conduct a complete program evaluation of the Agri-Food Trade Program. It should also continue to develop and use appropriate performance indicators to report the results of the program and the projects it funds.

Department's response. The Department agrees. A departmental evaluation of the AFTP is expected to be completed by June 2002. Likewise, an AFTP internal audit is included in the departmental multi-year grants and contributions audit strategy, and is currently scheduled for 2004–05.

Currently, the AFTP has five key performance measurement indicators that are reflected in the objectives of the program. Nonetheless, the planned winter/spring 2002 evaluation of the AFTP will address performance information gaps and include specific recommendations to both revise and report on performance indicators, particularly in the context of the departmental performance report.

Project assessment and approval

5.39 **Approval process.** Applicants for funding under the Agri-Food Industry Market Strategies (AIMS), a component of the AFTP, submit a project strategy each year, which is assessed by a working group comprising mainly officials of Agriculture and Agri-Food Canada. The working group evaluates the validity and soundness of the strategy and forwards a recommendation to the AIMS Steering Committee, which reviews the project and approves the funding.

5.40 For stand-alone projects that do not come under AIMS, organizations apply directly to the Agri-Food Trade Program for funding. A project officer is assigned to review each of those projects. Before making a recommendation, the project officer forwards the application to two other departmental officials in a different responsibility centre for peer review. All projects and recommendations are reviewed by a management committee, which decides whether to approve the project or not.

5.41 **Quality of strategies varies.** We expected that the Agri-Food Trade Program would exercise due diligence in approving each project.

5.42 We found that the quality of the project strategies funded under AIMS was generally good. However, 2 of the 23 project strategies we examined were weak, in that they did not identify priority markets, provide a five-year forecast of market demand, explain market priorities, assess the industry's capability to satisfy the demand, or specify achievable five-year goals.

5.43 **Problems with assessment of management and financial capability.** We expected the assessment of each project to take into account, at a minimum, all the review criteria under the program's terms and conditions. We could not assure ourselves that the management capability and financial capacity of the applicants were assessed in any of the projects we examined. In other words, there was little evidence that the applicant's ability to complete the project had been formally assessed; nor was the applicant's need for government funding explicitly demonstrated.

5.44 Management informed us that the working group leaders assess the financial capacities and management capabilities of applicants based on their day-to-day relations and their knowledge of the associations and industry sectors. However, these assessments are not documented in the project files. In cases where the assessments indicate a potential problem, the working group contacts the applicant and flags the issue for the steering committee and program management. Management has agreed that in the future it will formally document the assessment of an applicant's financial capacity and management capability.

5.45 **No move toward self-sufficiency.** Most of the AIMS projects are recurring activities over several years. One objective of AIMS is to help trade associations eventually become self-sufficient. We expected to see a strategy for helping applicants achieve self-sufficiency.

5.46 Although the funding approvals provide exit strategies for federal involvement, we saw little effort by project officers to move funding recipients toward self-sufficiency. In none of the projects we audited was it clear that self-sufficiency would be achieved.

5.47 **Recommendation.** The Department should ensure that the eligibility of each applicant is formally assessed against all the established criteria and that the assessment is properly documented.

Department's response. The Department partially agrees. The Department believes that each applicant is assessed against all established criteria but acknowledges that this information was not properly documented in each project file. Program administration has already implemented a formal checklist to ensure that applicant assessments are properly documented on project files.

Project and financial monitoring

5.48 **Adequate project and financial monitoring.** We expected management to have reasonable assurance that funding is used for the intended purposes. All contribution agreements require recipients to provide periodic progress or activity reports and a final report at the end of the project. There is a holdback on the payment of the final expense claim until the final report is received. We found that the reports have been submitted more or less on time. Most of the claims submitted by the applicants are audited by an independent auditor before the program reimburses expenses. Where there is no audit, management reviews the claimed expenses. In addition, three recipients are selected each year and audited to determine whether they have respected the terms and conditions of the contribution agreements. In our view, project and financial monitoring is adequate. However, we identified a few areas where improvements could be made.

5.49 Although contribution agreements require that recipients provide progress reports and final reports, we found that there is no system to signal when reports are due and no procedure to record their receipt. Project officers do not always review final reports to determine the extent to which projects achieved the objectives outlined in their strategies. The procedures manual requires that project officers prepare a written evaluation at the end of the project to compare the project results with the objectives. Several of the files we reviewed did not contain these evaluations. Management has indicated that in the future these evaluations will be completed.

Conclusion

5.50 We found that management has adequate financial control over program spending as well as adequate project monitoring and has taken some initiatives to manage risks. Management informs us that it has begun establishing clear expected results for the program. While management collects information on the results of individual projects, these are not compiled and used to assess and report program performance. We found that projects were assessed thoroughly against most of the required criteria, however, we could not assure ourselves that the capacity of recipients to carry out the projects or their need for funding had been adequately considered.

Section 2

Canada Economic Development for Quebec Regions—IDEA-SME Program and Regional Strategic Initiatives

In brief The IDEA-SME Program (Innovation Development Entrepreneurship and Access) for small and medium-sized enterprises (SMEs) begun in 1995; it is designed to help SMEs increase their business opportunities and participate more actively in improving the development potential of all Quebec regions. The Regional Strategic Initiatives program funds initiatives developed by private or public sector partners and helps create economic development opportunities to stimulate investment and job creation. We examined $90 million in spending by the two programs during the period April 1999 to September 2000.

An evaluation of the IDEA-SME program in 2000 that focussed on the program's effectiveness and relevance demonstrated that it has had some success. We found that generally the assessment of applications under both programs was complete and thorough, but we could not assure ourselves that its assessment of the level of risk and expected results of some projects was adequate. We are generally satisfied with the financial controls of Canada Economic Development for Quebec Regions (the Agency) on project spending, with the exception of advance payments. Further, in December 1999 it put new measures in place that should improve the monitoring of project results.

Background

5.51 The IDEA-SME Program funds projects by SMEs and organizations in three areas of activity: innovation, research and development, and design; market development and export trade; and entrepreneurship—business climate development.

5.52 The Regional Strategic Initiatives (RSI) program, begun in 1997, provides funding for initiatives by private or public sector partners. Its objectives are to contribute to economic development by stimulating investment and job creation and to ensure that the federal government acts consistently for effective horizontal management. The program focusses on four areas of activity: development of the technological capability of the regions; international tourism development; support for the drawing power and international reach of Quebec regions; and support for the adjustment capability of the regions in the new climate of globalization.

5.53 From 1996 to 2001, the IDEA-SME program funded 3,000 projects with an average contribution of $103,000. The RSI program contributed an average of $491,000, to 426 projects. Total annual spending of both programs was $104 million in 1999–2000 and in 2000–01.

5.54 The programs are the responsibility of Canada Economic Development for Quebec Regions. It has 160 employees at headquarters and in 14 regional offices and an annual operating budget of $12 million.

Focus of the audit

5.55 The objective of our audit was to determine whether the Agency had adequate control over the IDEA-SME and RSI programs. We examined IDEA-SME contributions selected from the $76 million in disbursements made by the program between 1 April 1999 and 30 September 2000 and $14 million in contributions by the RSI program in the same period.

5.56 Further details on the audit can be found at the end of this chapter in About the Audits.

Observations and Recommendations

Program design

5.57 When the IDEA-SME and RSI programs began, the Agency developed a detailed management framework. The framework specifies and elaborates on the terms and conditions approved by the Treasury Board. It sets out the programs' objectives; criteria for project assessment; and for each area of activity, the Agency's objectives and priorities, eligibility criteria (client base, activities, and costs), and the type and level of assistance authorized. In our view, this framework is relevant and clear.

5.58 **Improvements in program management.** Since the programs' inception, and particularly since 1997, the Agency has carried out various surveys, analyses, internal audits, and evaluations of program management and performance. Based on their findings and recommendations, it has made a number of improvements in its management framework and practices. In particular, it defined various elements of the framework, developed reference documents for assessing and monitoring projects, established a performance measurement policy and tools, and provided staff with related training.

Program performance

5.59 We acknowledge the Agency's efforts at ongoing performance measurement and identification of lessons learned throughout the five years of the IDEA-SME program. The Agency compiled the results of the principal assessments, surveys, and audits it has completed and presented them in a "summation" evaluation report.

5.60 The evaluation report notes that the IDEA-SME program has achieved significant results in the areas of employment and profitability of the businesses it has assisted; the general objectives of the program are still relevant; the program meets the needs of small and medium-sized enterprises throughout Quebec; the program must continue to adapt to regional realities; and there is a high level of client satisfaction with the services received. The report suggests some improvements in management practices, service delivery, and the management of partnerships.

5.61 An evaluation of the RSI program is scheduled for 2001–02.

Quality of information to Parliament has improved

5.62 In our December 2000 Report, Chapter 19, Reporting Performance to Parliament: Progress Too Slow, we noted that the information provided by the Agency had improved consistently in the last few years. Our audit this year looked at the information it provided on the IDEA-SME and RSI programs in its 1999–2000 *Performance Report*.

5.63 In that report, the Agency provides an overview of its clientele and activities and describes its achievements and those of its partner groups. It also describes the lessons learned from its various assessments and surveys and the steps it plans to improve its practices. Furthermore, although the *Performance Report* emphasizes the results achieved in the preceding 12 months, it indicates the long-term impact of the Agency's activities on employment in small and medium-sized enterprises.

5.64 Based on our review, we believe that certain improvements are still needed. In particular, the Agency needs to describe more clearly the results it expects for each key commitment, explain the limitations of its methods of measuring performance, provide more balanced information, and disclose its share of funding of large-scale projects, particularly in the RSI program. We noted that the Agency responded well to the reporting requirements of the new Policy on Transfer Payments in its 2001–02 *Report on Plans and Priorities*.

Project assessment and approval

5.65 Under the terms of both programs, the decision to invest in a project and the level of funding to contribute are based on criteria that include the project's fit with the Agency's objectives and priorities as well as those of the region; the potential economic and commercial impact on the enterprise and the region; the strategic, technical, and financial capacities of the applicant; the level of risk involved; the project's impact on sustainable development; and the availability of funds. The RSI program includes additional criteria: the leveraging effect of the contribution on the planned size and schedule of the project; and the project's priority in the community, the community's involvement in its funding, and the capacity to generate funds. An internal directive stipulates that incentive effects of IDEA-SME contributions must also be analyzed.

5.66 We expected that the decision to invest in a project and the level of funding authorized would take into account all of these criteria and be adequately supported. Projects that represent value added for the Agency and the government are those that optimize the use of available public funds and achieve the expected results. The assessment of project applications must therefore consider the advantages to the Agency of investing in a project and the incentive effects of its contribution.

5.67 The projects we looked at were generally consistent with program objectives. The applications were assessed appropriately for the applicant's strategic, financial, and technical capacities and the project's potential impact on sustainable development. In most cases, the assessment showed the incentive effect of the contribution.

5.68 However, we found weaknesses in the assessment of project risk and of the expected economic and commercial results. We audited a total of $90 million in contributions to projects between 1 April 1999 and 30 September 2000; for $50 million of that we could not assure ourselves that the project had been assessed adequately against at least one of these two criteria.

5.69 **Lack of consistency in assessing project risk.** Of the projects we reviewed, the assessments of 56 percent did not include the level of risk involved. Most of them noted various elements of risk but made no final assessment. In our discussions with staff, we found that their understanding of risk was not consistent. Some view risk as limited to the non-repayment of a repayable contribution. Others may not document the risk assessment clearly, but the special conditions they require in the contribution agreement reflect their assessment. However, the links between the agreement conditions and the elements of risk identified are not always apparent. Some staff told us that where no level of risk is indicated, the risk is low. However, their conclusions were not supported by a formal analysis.

5.70 **Management based on risk.** We did not find any departmental directive on auditing payments and monitoring projects according to level of risk, nor a formal risk management strategy. The Agency has used a risk rating tool since December 1999 to assess the risk of non-repayment of contributions. This tool permits staff to assign a score, based on a point scale, to various aspects of the project and the organization that is applying, such as financial situation, skills and experience of managers, and the technical and commercial risks of the project. This is a sound practice. However, the Agency could expand the use of this tool to all projects and could add criteria for assessing risk. The risk assessment would be used not only to help decide whether to invest in a project but also to improve the targeting of financial and performance monitoring.

5.71 **Expected economic and commercial impacts of projects are not specific enough.** The Agency funds organizations that offer services to SMEs in order to benefit from their knowledge and expertise in specific areas and to diversify its service delivery. Given the intermediary role of these organizations between the Agency and the SMEs, we would expect the contribution agreements with them to indicate the expected results of projects in clear, concrete, and measurable terms in order to achieve the intended economic and commercial impacts of the program.

5.72 In 36 percent of the projects we reviewed, the contribution agreements did not outline the expected results clearly. The descriptions and goals of projects were also worded in vague and general terms, such as "allow the continuation of activities, notably . . . " and "ensure the existence of the organization, whose mission consists of . . . consolidat[ing] operations and develop[ing] . . . new activities."

5.73 The Agency recognized this weakness in *Lessons Learned From Evaluations Done in 1998–99*. At the end of December 1999, it developed a framework for continuous performance measurement of projects carried out by non-profit organizations. Since then, all agreements with such organizations must identify for each project the objectives, the expected short-term outputs and medium-term results, and performance indicators. A performance monitoring tool has also been developed. Furthermore, staff have received training in continuous performance measurement and the role of intermediary groups.

5.74 To date, there has been no review of these tools or structured comparison of their content and quality. Such an exercise would help identify good practices, lessons learned, and improvements needed.

5.75 **Need to justify the level of funding provided.** The IDEA-SME program's management framework generally limits the level of funding by the program to 50 percent of a project's allowable costs. However, an exception to this rule is possible if the need for a higher percentage is demonstrated. We found that in 5 of the 11 projects whose funding exceeded this limit, the excess was not adequately justified. The limit was exceeded by a total of $1.6 million in these 5 cases.

5.76 **Recommendation.** The Agency should ensure that the level of risk and the economic and commercial impacts of projects are evaluated thoroughly and should justify adequately the funding it provides in excess of the established limit.

Agency's response. The Agency already automatically assesses the risk of non-repayment of a contribution. However, the Agency is reviewing its assessment model, which will include a specific section on the level of risk taken in financial terms and in terms of the level of expected results.

In the summer of 2001 the Agency conducted a study of intermediaries to determine the best practices in establishing expected results, to identify deficiencies, and to propose solutions. This review will, among other things, improve the assessment of the economic and commercial impact of projects.

Program management frameworks already require that funding in excess of the limits set out in a framework be adequately clarified. To emphasize this point more, we will amend the program review summary to require this adequate clarification when the level of funding exceeds the limit set out in the management framework.

Project and financial monitoring

Financial management and control

5.77 In general, we found that the audit of claims for payment is adequate, and payments made are for allowable costs. However, the Agency needs to be clearer about the extent and nature of audit that it expects in order to ensure consistency and take into account project risks. The new payment procedures introduced in the fall of 1999, for example, allow for the possibility of requiring in the agreement an accountant's report on claimed expenses. The Agency has provided no written guidance to its managers on how to decide whether or not to require such a report.

5.78 **Advance payments are not properly supported.** The Treasury Board's Policy on Transfer Payments allows for advance payments when they are "based on prudent cash management principles." That is, the amount of each advance payment must be limited to the recipient's immediate cash requirements. Cash requirements are based on the recipient's monthly cash flow forecasts, taking into account any advances outstanding. We expect that the Agency would comply with the policy.

5.79 The Agency made advance payments to 25 of the projects in our sample. It views advances as specifically intended to assist non-profit organizations and private businesses in the start-up phase of projects that will benefit the economic well-being of Canadians. We found that in 21 of the 25 projects, the advances were not supported by the required cash flow forecast. In 9 cases, the Agency received the expense claims anywhere from 6 to 24 months after it had made the advance payment. Moreover, the amounts claimed were not always as large as the amounts paid in advance, which puts into question the level of those advances. We noted, for example, that an organization received an advance of $2.9 million in March 2000, based on an estimate of its expenses for two months (March and April). The forecast represented 80 percent of the total amount allocated to the organization for consulting services during the five-year duration of the project. A claim for the actual costs had not yet been filed at December 2000.

5.80 The internal auditors made similar comments in their October 2000 report. The Agency informed us that it has since brought its policy on advance payments into line with that of the Treasury Board.

5.81 **Recommendation.** The Agency should comply with the Treasury Board's policy on advance payments.

Agency's response. The Agency has already followed up on the comments of internal auditors on this matter in October 2000. It has since brought its policy on advance payments into line with the Treasury Board's Policy on Transfer Payments.

Project monitoring

5.82 We expected the Agency to be aware of how funded projects were performing, that is, aware of their activities and results. We therefore expected to see appropriate monitoring during the life of each project and at its completion.

5.83 **Reasonable project monitoring in most cases.** We found that in most cases the Agency monitors and documents the progress of projects adequately. It monitors projects in various ways, such as reviewing activity reports submitted with claims for payment, reviewing the quarterly follow-up reports introduced in July 1999, and participating as an observer on boards of directors or operating boards of several non-profit organizations.

5.84 **Performance measurement needs to improve.** We also looked at whether the Agency had assessed results at the end of projects. We found that in 15 of 22 completed projects (68 percent) it had measured certain results. However, we saw no comparative analysis or explanation of the significant differences between expected and actual results. Furthermore, in eight projects of non-profit organizations the initial objectives were not clear or measurable. Consequently, although it measured project performance, the Agency could not draw any conclusions about the achievement of results. These are particularly important gaps because the Agency has renewed its contribution agreements with a number of non-profit organizations.

5.85 As already noted, the Agency began continuous measurement of the performance of all projects approved after 1999 and carried out by non-profit organizations. The contribution agreements we examined that were approved after that date contained the required information.

5.86 The Agency has conducted annual surveys of its SME clientele since 1997. These surveys enable it to measure the performance of projects it has authorized throughout the year as well as measuring client satisfaction. It carried out two long-term surveys to determine how projects were performing three years after receiving the Agency's contribution. We did not review the survey methodology or results in depth. Consequently, we cannot comment on the quality of the information the survey generated. However, these are interesting initiatives that may provide valuable information on results within the framework of continuous performance measurement.

5.87 **Recommendation.** The Agency should

- ensure that it identifies the expected results at the outset of projects, describes them in concrete and measurable terms, and establishes a timeframe for their achievement
- ensure that the difference between expected and achieved results is assess and take that information into account when renewing agreements.

Agency's response. In December 1999, the Agency implemented performance monitoring for all projects. In addition, it is implementing a training program on performance evaluation, which will be given to all advisors this fiscal year. This training will deal specifically with defining expected results in concrete and measurable terms. Advisors will be better able to state, at the outset of projects, the expected results and the time frames established, based on the nature of the project.

Furthermore, the Agency has developed a scorecard for the results achieved in projects carried out, notably with intermediaries. This scorecard compares the actual results with the expected results, explains the variances, and describes the measures to take to correct the situation, if needed. This analysis of the results will serve as a benchmark in the renewal of agreements.

Conclusion

5.88 An evaluation of the IDEA-SME program in 2000 that focussed on the program's effectiveness and relevance demonstrated that it has had some success. We found that generally the assessment of applications under both programs was complete and thorough, but we could not assure ourselves that its assessment of the level of risk and expected results of some projects was adequate. We are generally satisfied with the Agency's financial controls on project spending, with the exception of advance payments. Further, in December 1999 it put new measures in place that should improve the monitoring of project results.

Canadian Institutes of Health Research—Operating Grants Program

In brief

The Canadian Institutes of Health Research (CIHR or the Agency) was established in June 2000. Its programs build upon and expand those of the Medical Research Council, which had existed since 1969. The objectives of the CIHR programs are to excel, according to international standards of scientific excellence, in creating new knowledge and translating it into improved health for Canadians, more effective health services and products, and a strengthened Canadian health care system. We audited CIHR's expenditures for research operating grants in 2000–01, a total of $190 million.

We found that CIHR's assessment of applications for operating grants was complete and thorough. It uses a rigorous peer review system to identify projects for funding. However, we found that its monitoring of how quickly researchers spend their grants needs to improve, as does the tracking of research results. CIHR also needs to improve its assessment and reporting of program performance.

Background

5.89 All elements of the former Medical Research Council's mandate are incorporated in that of the Canadian Institutes of Health Research: to promote and assist research in the health sciences by funding research and training in research at Canadian universities, research institutes, and hospitals. However, the Canadian Institutes of Health Research has a much broader mandate that includes intersectoral, interprovincial, and international consultation and partnering. It also has a mandate to translate new knowledge into health innovations. Furthermore, the structure of CIHR, with virtual institutes across Canada focussed on specific areas of health or the health of specific population groups, is much more integrated than its predecessor's.

5.90 We audited the CIHR's operating grants program. As the audit commenced about six months after the launch of CIHR, the program was essentially the same as the Medical Research Council had been delivering at the time that its assets, liabilities, grants, and related funding were transferred to the new agency.

5.91 The total budget for grants and scholarships for the last three years is shown in Exhibit 5.1. Operating grants are made to support projects directed toward defined research objectives. The projects are conducted by teams led by an investigator or several investigators. Grants can be active for six months to five years.

Exhibit 5.1 Grant and scholarship expenditures, 1999 to 2001 ($ millions)

[illegible]	[illegible]	[illegible]	[illegible]
Research grants (including operating grants)	210	217	265
Other grants and scholarships	49	79	105
[illegible]	[illegible]	[illegible]	370

[1] Medical Research Council
[2] Medical Research Council and Canadian Institutes of Health Research

Focus of the audit

5.92 Our audit covered the payments made by the operating grants program in fiscal year 2000–01. Operating grants that year totalled roughly $190 million. We audited a sample of project files; interviewed CIHR officials, selection committee members, and grant administrators; and visited some grant recipients and some other research organizations. We reviewed literature on similar programs in other countries.

5.93 The objective of the audit was to determine whether CIHR had adequate control over operating grants. Further details on the audit can be found in About the Audits at the end of the chapter.

Observations and Recommendations

Program design

5.94 **Program objectives.** We expected management to ensure that grant programs were designed to achieve results, manage risks, ensure due diligence in spending, and provide accountability for public funds spent. We found that management has established reasonably clear objectives for its research grants program. The objectives are consistent with the mandate and policy of the organization. The objective of the CIHR is to excel, according to internationally accepted standards of excellence, in creating new knowledge and translating it into improved health for Canadians, more effective health services and products, and a strengthened Canadian health care system.

5.95 **There is no formal risk management strategy.** Risk management is designed to strengthen management practices, decision making, and priority setting. CIHR does not have a formal strategy for identifying and managing risks in its program operations. A risk management strategy would help it to identify, analyze, assess, monitor, and control risks at each stage of the grant cycle, and would help prevent unsatisfactory or unintended outcomes. Nevertheless, to manage some specific risks it does have in place such processes and procedures as verification of data, oversight committees, policies on conflict of interest and confidentiality, and systems for selecting the most appropriate reviewers of grant applications. CIHR management told

Exhibit 5.1 Grant and scholarship expenditures, 1999 to 2001 ($ millions)

[illegible]	[illegible]	[illegible]	[illegible]
Research grants (including operating grants)	210	217	265
Other grants and scholarships	49	79	105
[illegible]	[illegible]	[illegible]	[illegible]

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Observations and Recommendations

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us that an enterprise-wide risk assessment and risk management strategy would be completed in fiscal year 2001–02.

5.96 **CIHR is developing an internal audit function.** Internal audit and evaluation are key elements of internal control and could play a major role in project and financial monitoring. Management had not established an internal audit function and, accordingly, the operating grants program has not been audited. During our audit, CIHR requested additional resources for internal audit and program evaluation functions. It recently developed an internal audit policy that it is ready to implement.

5.97 **Recommendation.** CIHR should develop a formal risk assessment and management strategy and should establish an internal audit function.

Agency's response. As a new agency, launched in June 2000, CIHR is strengthening key functions in pursuit of its goal of being a model results-based organization. We are currently undergoing an enterprise-wide risk assessment as the initial stage of developing a formal risk management strategy. This will be followed by an appropriately resourced internal audit function.

Program performance

5.98 **Little information on program performance.** We expected that management would know whether programs are achieving expected results. Government programs are supposed to be evaluated periodically, normally every five years. Program evaluation encourages efficiency, effectiveness, and accountability in program spending.

5.99 We found that management had conducted some studies of the operating grants program and other grant programs. However, it had not specifically addressed the four evaluation issues indicated in the Treasury Board evaluation guidelines: the program's rationale, impact, achievement of objectives, and alternatives.

5.100 CIHR management told us that it would complete an evaluation of the operating grants program in fiscal year 2002–03.

5.101 **Reporting performance to Parliament could be improved.** We expected that management would report clearly to Parliament on the performance of the operating grants program. Our review of its performance reports for 1998–99 and 1999–2000 found that the quantitative information they contained on performance was limited. Performance measures developed so far for research grants focus more on activities and inputs than on outcomes. The program's impact on health and the economy tends to be reported anecdotally, by specific case, rather than as measured by program-wide indicators. Dollars spent, number of scientists trained, numbers of scientists and projects supported, and number of research publications produced are necessary indicators of program performance but alone are not sufficient. Management needs to assess its performance toward achieving the results expected from the operating grants program. Under the revised Treasury Board Policy on Transfer Payments effective June 2000, the specific objectives and results planned for grant and contribution programs over $5 million must be stated clearly in the entity's report on plans and priorities, together with milestones for achievement. We noted that in CIHR's 2001–02 report, information on its objectives and planned results was provided.

5.102 At the time of our audit, CIHR was developing a strategy for collecting timely and accurate information on the results of its investments in research. It was also developing a set of performance indicators.

5.103 **Recommendation.** CIHR should conduct an evaluation of its operating grants program that addresses all four evaluation issues stipulated in the Treasury Board guidelines. It should also develop and use appropriate performance indicators to monitor and report the results achieved by research that it funds.

Agency's response. CIHR has already commenced a formal, in-depth evaluation of the operating grants program and expects results by November 2002. A Results-Based Management and Accountability Framework for the program, targeted for February 2002, will identify a best set of indicators for measuring ongoing performance. Activities such as these will deepen and enrich the information base for program management and for CIHR's reporting to Parliament and Canadians.

Project assessment and approval

5.104 **Approval process.** All applications for research grants go through a competitive process. To make sure that it funds only high-quality research proposals, CIHR uses a peer review system. Applications are screened initially by CIHR staff to ensure that applicants have submitted all the required information. A grant assessment committee then reviews the applications in detail. Committees are made up of experts in various disciplines of the health sciences who are working scientists, mainly at Canadian universities. Many of these peer reviewers are themselves active in related research. Each research proposal is also sent to outside referees who specialize in the applicants' fields; the grant assessment committee considers the referees' comments in making the final assessment.

5.105 Applications are rated on a point scale and ranked in order of merit. The results of the competition and the staff recommendations for funding are scrutinized by an oversight committee. This is a standing committee of the Governing Council, composed of researchers and other stakeholders. It makes final recommendations to the Governing Council for its approval.

5.106 The eligibility criteria used in assessing the research proposals are scientific merit, potential impact of the work, originality, feasibility, relationship with applicant's previous work, and a critical review of the literature. After assessing scientific merit, the review committee examines the budget proposed by the applicant.

5.107 **Thorough assessment of applications for funding.** In our view, applications for operating grants that totalled $190 million were completely and thoroughly assessed. Grant files were complete and contained all pertinent information on the grants awarded. Standard grant applications, appraisal checklists and forms, approved notices of grant awards, budgets, and financial status reports are used to document and record all decisions by selection committees and outside reviewers and all the related processes.

Project and financial monitoring

5.108 Funds provided by CIHR for approved projects are administered by the business offices of the institutions at which the grant recipients are located—mainly universities, hospitals, and research institutes. The business offices not only maintain common grant accounts but also monitor expenditures charged to each research account. CIHR makes regular monthly or bi-monthly payments to these accounts based on the amounts it has approved.

5.109 **Unspent balances increasing.** We found that CIHR receives annual detailed statements of actual expenditures, by grant recipient, from the business offices of their institutions. We expected that CIHR would review these statements for large unspent balances to determine whether the pace of expenditures reflects the anticipated progress of the research and the corresponding budget. We found no evidence of systematic follow-up action to reduce unspent balances. CIHR management informed us that its payments to the research institution start two months after the project begins and are bi-monthly thereafter, regardless of the pattern of actual expenditures on the research project. CIHR also allows its researchers to use unspent balances that remain in their accounts for two years after funding ends, in order to wind down their projects or to seek funding from other sources.

5.110 Universities also submit annual summary financial status reports on all the CIHR-funded research projects conducted there. At 31 March 1999 the total unspent balance was $67 million; by 31 March 2000 it had grown to $95 million. At 31 March 2001, unspent balances totalled about $113 million among roughly 3,871 projects administered by 66 research institutions across the country. CIHR's total budget for grants and scholarships that year was about $370 million.

5.111 Although management was aware of this large balance, it did not investigate why it was increasing. CIHR intends to develop a process to identify, investigate, and reduce unusually large year-end balances in the future.

5.112 **No systematic tracking of research results.** We noted that management does not systematically assess the scientific results achieved for its $190 million support to research.

5.113 Recipients of research grants are not required to submit progress reports unless they have received five-year grants or they apply for a renewal. About 75 percent of recipients apply for new funds and, at that time, the review panel considers their productivity as measured by published research results. We found that management obtains the required progress reports both for five-year projects and for renewals but does not require a final report on research results when projects end. More important, CIHR does not have a framework for capturing the results of completed research as a basis for assessing program performance and providing information to Parliament.

5.114 CIHR management has indicated that it is committed to improving the ongoing measurement of performance where it will yield useful information for Canadians. There are many methods used to evaluate research results.

Exhibit 5.2 presents the advantages and disadvantages of using some of these methods.

5.115 **There was little on-site monitoring by management.** Site visits help ensure that funds entrusted to the research institutions are managed well and spent for the intended purposes. Visits are also useful to assess the progress of projects and collect information on the results of the funded research. Although management conducted some site visits as part of the appraisal process, they were to only a few major projects.

5.116 Management relied to a large extent on the financial and audit monitoring procedures in place at the research institutions. We noted that CIHR had not conducted site visits to examine the appropriateness of these procedures until 2000–01, when it started making monitoring visits jointly with other federal government research funding agencies.

Exhibit 5.2 Methods used to evaluate research results

Method	Advantages	Disadvantages
Bibliometric analysis	Quantitative Useful on an aggregate basis to evaluate quality of some programs and fields	At best, measures only quantity Not useful across all programs and fields Comparisons across fields or countries difficult Can be artificially influenced
Economic rate of return	Quantitative Shows economic benefits of research	Measures only financial benefits, not social benefits (such as improvements to health and quality) Time between research and economic benefit is often long Not useful across all programs and fields
Peer review	Well-understood method and practices Evaluates quality of research and sometimes other factors An existing part of most federal agency programs	Focusses primarily on research quality; other elements are secondary Usually evaluates research projects, not programs Great variance between agencies' uses of "old boys' network" Results depend on involvement of high-quality people
Case studies	Explains effects of institutional, organizational, and technical factors influencing research process so that process can be improved Illustrates all types of benefits of research process	Ad hoc cases not comparable across programs Focusses on cases that might involve many programs or fields, making it difficult to assess federal program benefit
Retrospective analysis	Identifies links between federal programs and innovations over long intervals of research investment	Not useful as a short-term evaluation tool because of long intervals between research and practical outcomes
Benchmarking	Provides a tool for comparison across programs and countries	Focusses on fields, not federal research programs

Source: Evaluating Federal Research Programs, National Academy Press, Washington, D.C., 1999

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Benchmarking	Provides a tool for comparison across programs and countries	Focusses on fields, not federal research programs

Source: Evaluating Federal Research Programs, National Academy Press, Washington, D.C., 1999

5.117 **Continuing eligibility needs to be verified.** CIHR is subject to the *Financial Administration Act*. A person authorizing a payment of public funds must certify under section 34 of the Act that the recipient of the money is eligible for or entitled to payment.

5.118 During the course of our audit, we noted that there was no certification under section 34 for grant payments made by CIHR in 2000–01. Management told us the risk was low that payments were made to ineligible recipients. Its financial systems allow grant payments to be made only by individuals with delegated authority.

5.119 Nevertheless, CIHR acknowledged that explicit certification under section 34 is required and it has resumed this practice. It also indicated that it would further strengthen its assurance of recipients' continued eligibility by having institutions specifically certify through a special annual report that grant recipients at their institutions are still eligible for funding.

5.120 **Recommendation.** CIHR should do the following:

- monitor the financial status of projects and take action when projects accumulate unspent balances higher than are normal; and
- develop an appropriate way to assess the results of the research projects it funds.

Agency's response. The Business Office at each grantee's institution provides CIHR management with accurate information on disbursements. As the rate of disbursement for research grants is affected by many unpredictable variables, it is to be expected that year-end accounting will show unspent balances. We appreciate the recommendation that unusually large balances should be individually investigated, and we are putting in place administrative processes so that, when appropriate, payments of grants may be adjusted to more closely reflect the researcher's rate of expenditure.

Our world-class peer review system ensures that CIHR supports good research by Canada's best health scientists. To better capture information on the results of that research, CIHR will have in place a performance measurement framework and strategy before the end of fiscal year 2001–02. We are determined to continually improve our capacity to keep Canadians informed of the important advances in knowledge resulting from their investment in the work of Canadian health researchers.

Conclusion

5.121 We found that CIHR carried out complete and thorough assessments of applications for operating grants. It uses a rigorous peer review system to identify projects for funding. However, we found that its monitoring of how quickly researchers spend their grants needs to improve, as does the tracking of research results. CIHR also needs to improve its assessment and reporting of program performance.

Section 4

Citizenship and Immigration Canada—Settlement Contribution Programs

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In brief The Settlement Contribution Programs of Citizenship and Immigration Canada are in a period of transition between a previous decision to devolve them to the provinces and, later, a decision that the Department would retain and manage them. Following the later decision, the Department began a significant reinvestment of resources in the programs.

We note that financial and management controls over settlement programs are adequate. However, the Department needs to strengthen on-site monitoring and provide its program officers with more financial training.

The Department's normal practice is to enter 12-month contribution agreements with its service providers. We believe it could gain efficiency by moving to a multi-year funding process. However, it should do this only after reaching a common understanding with service providers on its requirements for performance measurement and reporting. The Department does not yet have the data to gauge how well its settlement programs are performing. It has conducted no overall evaluation of its settlement programs since its creation.

Background

5.122 The Settlement Contribution Programs are delivered under two of Citizenship and Immigration Canada's five business lines: Promoting the Integration of Newcomers, and Maintaining Canada's Humanitarian Tradition. We audited the four settlement programs: Language Instruction for Newcomers to Canada (LINC), Immigrant Settlement and Adaptation Program (ISAP), the Host Program, and the Resettlement Assistance Program (RAP).

5.123 The overall objectives of the settlement programs are to help newcomers to Canada adapt, settle, and integrate. While the Department acts as a funding agency, service providers are responsible for actually delivering the programs. The Department enters into contribution agreements with them that specify the services they are to provide.

5.124 The terms and conditions for the language instruction, settlement and adaptation, and host programs state that agreements with service providers will not normally exceed 12 months. The terms and conditions for the Resettlement Assistance Program state that agreements with service providers will not normally exceed 36 months.

5.125 Under a 1991 Canada–Quebec accord, Quebec is solely responsible for settlement and integration services in that province and it receives a federal grant to provide those services. Agreements were also signed with Manitoba and British Columbia to transfer settlement services, effective January 1999 and April 1999 respectively. However, in both those provinces the Department still delivers the Resettlement Assistance Program.

5.126 **Language Instruction for Newcomers to Canada.** The objective of the language instruction program is to provide adult immigrants with training in one of Canada's official languages to help them integrate into Canada. The Department funds service providers to assess linguistic eligibility and provide language training and course material. Eligible individuals can receive the training whether or not they will enter the labour market. Clients may participate for up to three years from the start of training. The program also offers child-minding services and assists with transportation costs.

5.127 **Immigrant Settlement and Adaptation Program.** Service providers receive funding to provide direct services, such as the following:

- information and orientation on day-to-day activities (banking, shopping, managing a household, and so on);
- interpretation or translation services when necessary; and
- short-term counselling and employment-related services.

The Department also provides funds for improving the overall delivery of settlement services. This includes funds for research projects and staff training programs.

5.128 **Host Program.** The Host program funds service providers to recruit, train, match, and support Canadians and permanent residents who volunteer to serve as hosts. Hosts are expected to familiarize newcomers with Canadian ways and educate them about available services and how to use them.

5.129 **Resettlement Assistance Program.** Every year, Canada admits roughly 24,000 refugees. The government plans for roughly 7,300 of these as government-assisted refugees. Government-assisted refugees are selected at missions abroad and, once admitted, form the client group for the Resettlement Assistance Program. The program provides income support and immediate essential services to refugees who lack the resources to provide for their own basic needs. Income support is paid to government-assisted refugees directly by the Department as part of the Resettlement Assistance Program.

5.130 Income support accounts for over 70 percent of the program's $44 million in planned spending each year. The program provides income support for 12 months, or less if the refugee's income becomes enough to meet his or her own needs. Refugees with physical impairments or emotional problems can get up to 12 additional months of support if needed. Recipients are expected to report any change in their income, as this may reduce the income support provided.

5.131 Exhibit 5.3 presents the actual and forecast expenditures, by business line and by program, for the fiscal years 1999–2002.

Focus of the audit

5.132 The objectives of our audit were to determine the following:

- the adequacy of the financial and management controls over the contribution programs of the Department;
- how the Department has measured and reported the results achieved by the programs; and
- the Department's compliance with financial authorities.

5.133 We examined contribution and income support agreements that made payments between 1 April 1999 and 31 March 2000 under the four programs we audited. The Department also has an Immigrant Loans Program, which provides financial assistance to eligible applicants. Since that program is not one of the Department's grant or contribution programs, our audit did not include it. The Department submits a separate annual report to Parliament on the activities of that program. Further details on the audit can be found in About the Audits at the end of the chapter.

Exhibit 5.3 Summary of expenditures, by business line and program, 1999–2002 ($ millions)

[illegible]	[illegible]	[illegible]	[illegible]
Grants			
Promoting the Integration of Newcomers			
Grant for the Canada–Quebec accord	102.9	104.1[1]	101.7[1]
Grants to provinces	51.4	–	–
Total	**154.3**	**104.1**	**101.7**
Contributions			
Promoting the Integration of Newcomers			
Immigrant Settlement and Adaptation Program	32.2	16.0	18.1
Host Program	2.4	2.8	2.6
Language Instruction for Newcomers to Canada	95.6	99.7	106.2
Contributions to provinces to assist immigrants integrate into Canada	–	73.3[2]	47.8
Maintaining Canada's Humanitarian Tradition			
Resettlement Assistance Program	80.9	74.6	58.1
International Organization for Migration	1.1	2.0	2.0
Total	**212.2**	**268.4**	**234.8**
[illegible]	[illegible]	[illegible]	[illegible]

[1] Forecast and planned amounts will change due to the retroactive application of certain ongoing adjustment factors applied to the Canada-Quebec accord.
[2] Increase due to planned settlement realignment costs and the Kosovo relief effort.

Source: Citizenship and Immigration Canada

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Exhibit 5.3 **Summary of expenditures, by business line and program, 1999–2002 ($ millions)**

Business line and programs	**Actual expenditures 1999–2000**	**Forecast spending 2000–01**	**Planned spending 2001–02**
Grants			
Promoting the Integration of Newcomers			
Grant for the Canada–Quebec accord	102.9	[illegible]	[illegible]
Grants to provinces	51.4		
Total	154.3	104.1	101.7
Contributions			
Promoting the Integration of Newcomers			
Immigrant Settlement and Adaptation Program	[illegible]	[illegible]	[illegible]
Host Program	[illegible]	[illegible]	[illegible]
Language Instruction for Newcomers to Canada	[illegible]	[illegible]	[illegible]
Contributions to provinces to assist immigrants integrate into Canada		[illegible]	[illegible]
Maintaining Canada's Humanitarian Tradition			
Resettlement Assistance Program	[illegible]	[illegible]	[illegible]
International Organization for Migration	[illegible]		
Total	212.2	268.4	234.8
Total	**366.5**	**372.5**	**336.5**

[illegible]

Source: Citizenship and Immigration Canada

Observations and Recommendations

Program design

5.134 **Contribution accountability framework.** The settlement programs are in a period of transition. In 1995 the federal government announced that it wanted to withdraw from federal delivery of the programs. It proposed to finance the services through transfer payments to the provinces. To that end, the Department undertook a settlement renewal initiative from 1995 to 1999.

5.135 The announcement slowed down operations in all of the settlement programs, including new investments and initiatives. Four years of operating in a "wind-up" mode resulted in the closing of some local points of delivery, staff departures, and lack of investment in data systems to gather and report on program performance.

5.136 In 1999 the Minister decided not to actively seek new agreements with the provinces. The Department then began a significant reinvestment of resources in its settlement programs. A major initiative was to develop a contribution accountability framework. The Department's goal is that the framework, once completed, will help it ensure accountability for departmental expenditures, monitor service delivery, and evaluate the effectiveness of contribution programs in meeting the settlement needs of newcomers.

5.137 We reviewed the contribution accountability framework against the Treasury Board's policy on transfer payments. We believe that once all the elements of the framework are in place, the Department will be complying with the key provisions of the policy.

5.138 **Allocation of program funds to regions.** The Integration Branch at headquarters allocates program funds in a block to each of the Department's regions; the funds do not cover the Resettlement Assistance Program. The total amount provided annually since 1996–97 has been $173.3 million.

5.139 The amount of funding allocated to each region is based on a settlement allocation model. The model incorporates the number of recent immigrants in each province or territory (using a three-year rolling average of past immigrant landings) and the estimated costs of settlement services. Once allocated, the funds are administered by the regions and by the two provinces (British Columbia and Manitoba) that have assumed responsibility for settlement services under federal-provincial agreements.

5.140 The model does not apply to Quebec, which receives a grant determined by a formula in a Canada-Quebec accord as federal payment for settlement services provided by Quebec. The formula includes an escalation clause. As a result, the amount of the grant can either increase or remain the same but can never decrease. The amount payable to Quebec in 2001–02 is $101.7 million.

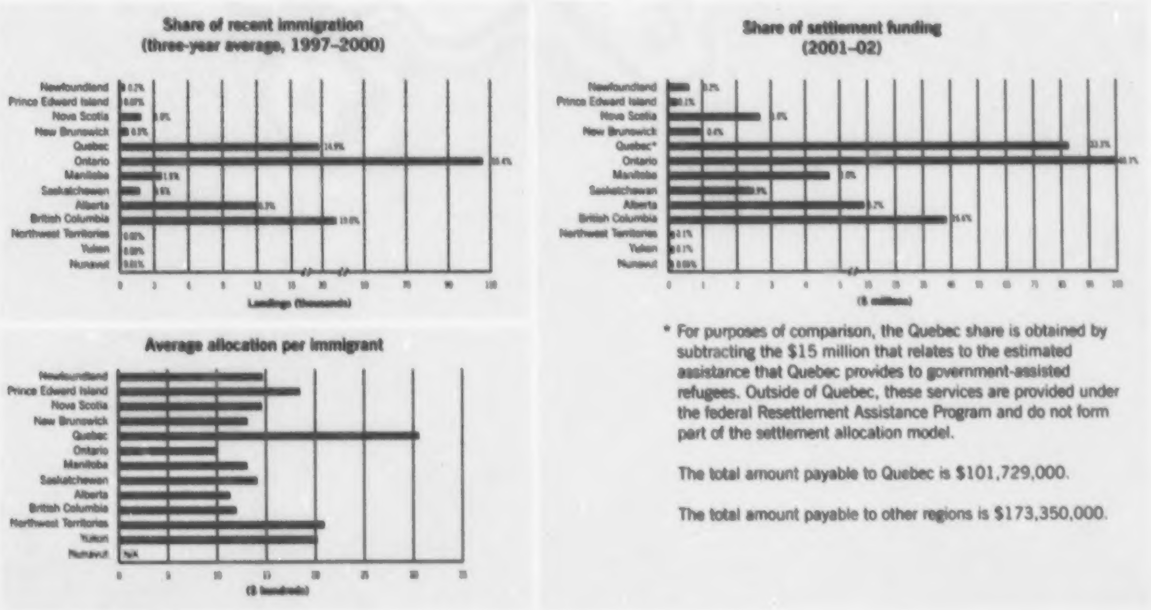
5.141 The Department provided us with the results of the settlement allocation model for 2001–02 (Exhibit 5.4). For purposes of comparison, it also included payments to Quebec.

5.142 The Refugees Branch at headquarters determines the regional funding levels for the Resettlement Assistance Program (RAP) outside Quebec. Funding for RAP is tied to the annual targets for government-assisted refugees. RAP funding is not included in the allocation arrived at by the settlement allocation model.

5.143 **Funding process for contribution agreements.** The Department's contribution agreements with service providers are normally for 12 months. Service providers submit an application and a detailed proposal that is analyzed by program officers. The program officers then complete an assessment/recommendation form for the proposal. This procedure is repeated each year in the Department for the several hundred service providers it funds. During our audit we noted that 95 percent of proposals were from service providers who had been funded previously.

5.144 We believe that moving to multi-year funding arrangements with well-performing service providers would be more efficient. However, this can be done only after the Department has put in place key elements of its contribution accountability framework. The Department hopes to have the elements in place by 2005. They must include a common understanding and agreement with service providers on what performance information and reporting the Department requires from them to assess the results of its settlement service programs.

Exhibit 5.4 Settlement allocation model



* For purposes of comparison, the Quebec share is obtained by subtracting the $15 million that relates to the estimated assistance that Quebec provides to government-assisted refugees. Outside of Quebec, these services are provided under the federal Resettlement Assistance Program and do not form part of the settlement allocation model.

The total amount payable to Quebec is $101,729,000.

The total amount payable to other regions is $173,350,000.

Source: Citizenship and Immigration Canada

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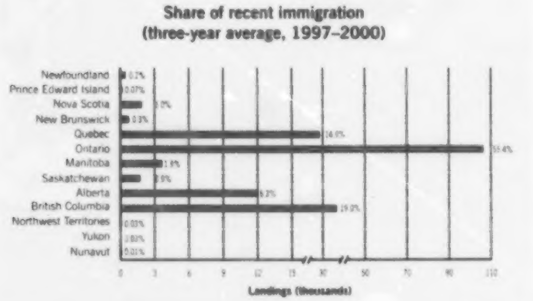
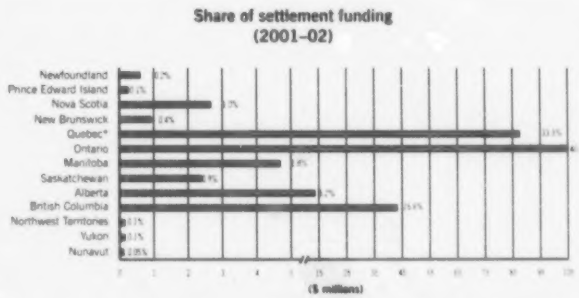
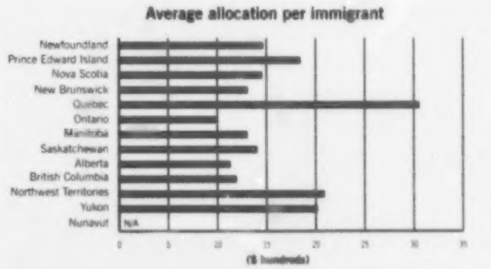

Share of recent immigration (three-year average, 1997–2000)


Share of settlement funding (2001–02)


Average allocation per immigrant

* For purposes of comparison, the Quebec share is obtained by subtracting the $15 million that relates to the estimated assistance that Quebec provides to government-assisted refugees. Outside of Quebec, these services are provided under the federal Resettlement Assistance Program and do not form part of the settlement allocation model.

The total amount payable to Quebec is $101,729,000.

The total amount payable to other regions is $173,350,000.

Source: Citizenship and Immigration Canada

5.145 **Recommendation.** When the Department finishes implementing its contribution accountability framework, it should consider moving to multi-year funding arrangements with service providers.

Department's response. The Department will consider moving to implement multi-year funding agreements for settlement programs once appropriate management controls and evaluation measures are in place. The Resettlement Assistance Program already allows for multi-year arrangements with service providers.

Program performance

5.146 Since its creation in 1994, the Department of Citizenship and Immigration has conducted no overall evaluation of its settlement programs. However, it has done some limited evaluation of a few pilot projects and other, smaller, regional programs. Evaluation frameworks have now been developed for all settlement programs and the Department plans to have them evaluated by 2004–05. It has indicated that this timing may be subject to change, depending on the availability of proper data for analysis. Meanwhile, in 2002–03, efforts will focus on elements such as service quality, client satisfaction, program design factors, and short-term impacts.

5.147 At present, the Department cannot assess how well its settlement service programs are performing. We noted the following:

- contribution agreements for language instruction, the largest program, do not call for a final report summarizing the results attained in the course of the agreement;
- service providers have not been given clear direction on reporting requirements and methods; and
- information presently available in the regions is not captured for use on a national basis.

5.148 We examined the Department's performance reports for recent years. We noted that the information they present on the settlement programs consists mainly of a general description of the services provided to newcomers rather than the overall results of the programs and the achievement of program objectives.

5.149 Performance measurement is the primary focus of the Department's current and planned work in settlement services for 2000 to 2002. The Department aims to be able to collect national performance data on all programs in electronic form by April 2002. In the meantime, national headquarters has started to collect standard data from all service providers.

Project assessment and approval

5.150 The selection and approval of projects for funding is similar for all service providers under the Language Instruction for Newcomers to Canada, Immigrant Settlement and Adaptation, and Host programs. Service providers submit proposals that the Department assesses, using the program criteria.

5.151 In 98 percent of the agreements we examined, we found that the proposals provided satisfactory details. The only exception was one agreement where the proposal could not be located. We also found a satisfactory level of review by program officers before they recommended approval of funding. We noted that program officers paid particular attention to the cash flow forecasts and budgets submitted by service providers.

5.152 Service providers for the Resettlement Assistance Program are selected and approved on the basis of their ability to satisfy the program officer that they can provide the required services. The program officer reviews the submitted proposal, visits the service provider's premises, and interviews its staff. Rates of payment are negotiated on the basis of costs and the target for government-assisted refugees destined for the area. We found a satisfactory level of review by program officers before they recommended proposals for funding.

Project and financial monitoring

5.153 **Language Instruction for Newcomers to Canada, Immigrant Settlement and Adaptation Program, and Host Program.** Contribution agreements call for service providers to submit both narrative and statistical reports. We noted that these reports were on file in all the agreements we examined. While we did not determine that every monthly report was on file, we were satisfied with the level of compliance with this requirement.

5.154 The analysis and payment of claims is an ongoing activity in the Department. Service providers submit claims that summarize expenditures, by category, for a given period (normally a month). Before approving payments, the program officer reviews the reasonableness and accuracy of the claims. We noted that program officers closely track the funds that remain available as they approve claims, so that actual costs do not exceed the costs stipulated in the contribution agreements. Overall, we found that claims are properly analyzed and the appropriate approvals obtained before payments are authorized.

5.155 Activity and financial monitoring can include formal site visits. One purpose of these visits is to document key aspects of compliance with the terms and conditions of the contribution agreements. National headquarters has provided guidelines on the number of site visits to be made. However, each region is expected to develop its own monitoring system based on its classifying of agreements according to risk. The number of visits, if any, is usually based on the dollar amount and complexity of the agreement as well as prior experience with the service provider.

5.156 Of the regions that make formal site visits, we found that some follow the guidelines on numbers of site visits while others do not. Where they do not, we noted that program officers keep abreast of service providers' activities by reviewing monthly reports and making informal contacts. From our interviews with program officers and our analyses of files, we were satisfied with the numbers of formal visits made in these regions.

5.157 We also noted that site visits are not made in some regions. Program officers in those regions indicated that they monitor the activities of service providers by informal contacts, review and analysis of claims, and periodic reports. We accept that informal monitoring is a good practice and can substitute for site visits, especially for low-value agreements, that is, those under $25,000. However, we do not believe it can substitute for formal visits where complex or high-value contribution agreements are in effect. For example, informal monitoring provides limited assurance that rates paid to employees comply with those indicated in the contribution agreements.

5.158 **Recommendation.** For higher-risk contribution agreements, the Department should conduct at least one formal site visit to monitor financial controls and project activities.

Department's response. As part of the contribution accountability framework, Citizenship and Immigration Canada is developing a monitoring framework and management controls to clarify the appropriate level of monitoring required for various types of agreements.

5.159 We found that program officers tended not to visit all locations of service providers who deliver their programs at several locations. There were no monitoring plans outlining the locations to be visited, nor were records kept indicating what locations had been visited. As a result, the Department does not know from year to year which locations of a particular service provider it has visited. Also, when files are transferred to new program officers there is no indication of past monitoring. This could mean that the same locations could be chosen again for monitoring and others not monitored at all.

5.160 **Recommendation.** The Department should ensure that where service providers are delivering services at several locations, the region develops monitoring plans and reports against them to ensure that all locations are monitored over time.

Department's response. Guidelines and procedures will be put in place to assist regions in developing and implementing a monitoring strategy to ensure the rotation of site visits for organizations with multiple sites.

5.161 Some program officers told us they do not feel appropriately trained to conduct visits for financial monitoring, especially of large service providers. They noted that they lack the necessary financial background and have been offered little training to assist them. The Ontario Region hired two auditors on contract in 1998 and three financial officers in June 2001 to provide support to program officers. Other regions have also identified the need for three financial officers; these positions had not been filled at the time of our visits.

5.162 A compliance audit involves an in-depth examination of the service provider's financial records. Program officers use their discretion to judge whether a service provider is to be audited. A discovery during a monitoring visit that a service provider is not complying with terms of the contribution agreement could lead to a compliance audit. At March 2001, the Ontario Region had completed 22 compliance audits; about a third of them concluded that the service providers had kept proper financial records and the expenses they claimed were allowable under the contribution agreements. However, over half of the audits completed to date have identified overpayments and other compliance issues. The overpayments were due to claims for salaries and expenses that were unrelated to the contribution agreement and expenses claimed without sufficient documentation. During our audit, we noted that the Department follows up on the results of compliance audits. In most cases, it is able to resolve the problems and recover any moneys it is owed. The amounts repaid to the Department ranged from less than $100 to about $112,000. In addition, the Atlantic Region had undertaken audits of all 10 of its language instruction service providers, which were being completed at the time of our fieldwork in March 2001.

5.163 **Resettlement Assistance Program.** The monitoring of service providers in the program varies among regions. In Ontario, it is similar to monitoring in other settlement programs. Monitoring practices of the other regions vary; some use formal visits and others use informal means of monitoring. Overall, we found that program officers have a good understanding of the operations of service providers.

5.164 Under a departmental guideline, at least 10 percent of income support recipients should be monitored. Monitoring is conducted through mail-in questionnaires, by telephone, or in direct interviews. We noted that monitoring focusses more on the appropriateness and level of services provided than on compliance. Most regions met the 10 percent guideline.

5.165 We examined 42 income support agreements and found that the Department had paid the correct amounts for rent, transportation, food, and incidentals. We also noted that appropriate approvals were obtained before money was disbursed.

5.166 **Resettlement Assistance Program, Kosovo.** After a request in 1999 from the United Nations High Commissioner for Refugees, Canada committed itself to provide a safe haven for 5,000 Kosovo refugees. The Minister of Citizenship and Immigration expedited the processing of these refugees, and the federal government covered the associated costs. As a group, the Kosovo refugees were considered special needs cases, eligible for income support for up to 24 months. The Kosovo effort started in May 1999 and ended in July 2001. The total cost of the effort was roughly $134.6 million. In total, 7,300 Kosovo refugees arrived in Canada and 2,421 had repatriated by July 2001.

5.167 Before the refugees arrived, the Department's settlement group provided them with basic information about Canada. Once in Canada, the settlement group arranged for identification, clothing, interpretation services, and provision of daily allowances. The Department then arranged for refugees to be matched with sponsors.

5.168 In addition to income support, we examined other payments associated with the Kosovo effort, including payments for clothing and transportation. We found that the need for the payments was well documented and proper steps were followed before the goods were distributed. We noted that the Department made an attempt to monitor 100 percent of the recipients eligible for income support payments. At June 2001, it had monitored roughly 85 percent of recipients.

5.169 The Kosovo effort came to a close at the end of July 2001. The Department's headquarters and its Corporate Review commissioned an extensive lessons-learned study, now being completed. In late 2001 or early 2002, the Department plans a conference to discuss the lessons learned. It plans to bring together all the participants in this effort, including service providers, staff from its regional offices and from other departments, refugees, and other participants. Lessons learned reports have already been prepared by different regions and their results will form the starting point for discussion at the conference.

Conclusion

5.170 In general, we found the Department's financial and management controls over its settlement contribution programs to be adequate. Two areas requiring improvement are the on-site monitoring of service providers and financial training for program officers.

5.171 The Department has not been measuring the results of its settlement contribution programs. It has not carried out any overall evaluation of them since its creation as a department. Information on the programs in its performance report to Parliament is limited to a general description of the services provided to newcomers.

5.172 The Department has started to make progress in capturing data for the purpose of measuring and reporting results. It is developing a contribution accountability framework. It has completed evaluation frameworks and intends to evaluate its programs once the proper data are available. These are all steps in the right direction. The Department needs to sustain these efforts to ensure that it meets its stated goal of implementing its contribution accountability framework by 2005.

Section 5

Department of Canadian Heritage—Support for Official-Language Communities

In brief Support for Official-Language Communities is a component of the Promotion of Official Languages Program. Its purpose is to enhance the vitality of the English and French minority communities in Canada and to support and assist in their development. Expenditures for 2000–01 totalled $33 million. Some 380 organizations receive funding annually from the program.

We found that the program needs significant improvements in its management framework, performance information, project assessment, and analysis of the results achieved. The program's objectives and expected results are stated in vague and general terms, and the program has not been evaluated since the *Official Languages Act* was amended in 1988. The Department of Canadian Heritage has not developed performance indicators, and its reports to Parliament mainly discuss program activities rather than the program's results. There were also problems in the Department's assessment of projects that accounted for 33 percent or $9 million of the $27.5 million in program expenditures we audited. Finally, analysis of the results achieved by projects lacked rigour.

In the past year, the Department of Canadian Heritage has introduced several measures to improve the management of the program. Although it is too soon to know how effective these measures will be, they should address several of the problems we identified.

Background

5.173 Parliament amended the *Official Languages Act* in 1988. The Act sets out the obligation to use the two official languages in delivering government services and in federal institutions. It also sets out the federal government's commitment to promote bilingualism in Canadian society and to support and assist in the development of minority-language communities in Canada.

5.174 The Official Languages Support Program comprises the Promotion of Official Languages Program and the Official Languages in Education Program. As part of the Promotion of Official Languages Program, the Department of Canadian Heritage signed 15 agreements with official language minority communities. The purpose of these agreements is to give the communities greater responsibility for determining their own needs and priorities and deciding who should receive funding and how much.

Focus of the audit

5.175 Our audit focussed on Support for Official-Language Communities (a component of the Promotion of Official Languages Program), which spent a total of $33 million in 2000–01. The objective of the audit was to determine whether the Department had adequate control of the program.

5.176 We examined the projects approved for funding between 1 April and 31 December 2000 for the 2000–01 fiscal year, which represented about $27.5 million. We co-ordinated our audit with that of internal audit and relied on its work to minimize duplication.

5.177 Further details on the audit can be found at the end of this chapter in About the Audits.

Observations and Recommendations

Program design

5.178 The objective of the Support for Official-Languages Communities program is set out in section 41 of the *Official Languages Act* (1988), namely, "to enhance the vitality of the English and French linguistic minority communities in Canada and assist their development." The Department of Canadian Heritage defines the program's objectives as "to increase the ability of official language minority communities to live in their own language and in their own environment as strong, vibrant and healthy communities and to participate fully in all sectors of activity in Canadian society."

5.179 **Expected results need to be defined clearly.** Increasing the abilities of an official language minority community is a very broad objective. A recent internal audit report said that such generally stated objectives make it difficult to assess the overall results, impacts, and added value of the program. It is important for the Department that the expected results of the program be clarified, taking into account available resources. Clearly defined expected results are essential to a sound program design and enable the Department to measure the results actually achieved by the program. The Department has not yet finished developing performance measures for use in monitoring and evaluating results achieved. Nor has it developed a formal risk management strategy at the program level.

Program performance

5.180 **Limited evaluation.** In January 1997, the Department carried out an evaluation of the implementation of its Canada-community agreements. The evaluation found that the agreements allowed communities to take certain responsibilities, establish their own priorities to a certain extent, make better use of the available resources, and take more consistent action at the community level. However, the evaluation was not intended to measure the achievement of the program's overall objective, and in fact the program has not been evaluated since the *Official Languages Act* was amended in 1988. The Department has told us that an evaluation of official languages support programs is scheduled for 2002–03.

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5.181 Reports to Parliament are limited to program activities. In addition to publishing an annual performance report, under section 44 of the *Official Languages Act* the Minister of Canadian Heritage is required, within a reasonable time after the end of each fiscal year, to submit an annual report to Parliament on the matters related to the Department's mandate for official languages.

5.182 These reports describe mainly the program's activities. Although that information may be relevant, it does not address the program's performance or the results it has achieved. We also noted in the projects that we reviewed that the Department had not always obtained information on their results or had not reviewed the information to better measure the results achieved. In our view, the Department has not specified clearly in its annual reports on plans and priorities the results it expects from this program.

5.183 Recommendation. The Department should clarify the objectives of the Support for Official-Language Communities program by setting clear and concrete expected results, evaluate the program's effectiveness, develop indicators to measure the performance of the program, and report the results to Parliament.

Department's response. The Department accepts this recommendation. It has indeed begun implementing it as part of its plan to improve the management practices of the Official Languages Support Programs.

In December 2000, the Department began developing a results-based management and accountability framework for the Official Languages Support Programs. It is now identifying indicators and tools to gather relevant data for results measurement and will then develop a risk-based audit framework. The entire exercise should be finished in March 2002.

The Department is now completing an integrated results-based management and accountability and risk-based audit framework for the Support for Official-Language Communities program. This framework sets out the issues for the evaluation to be carried out next year, in 2002–03. After this evaluation, the Department will be in a better position to present the results of this program in the annual report on official languages and the departmental performance report, both of which are submitted to Parliament. Moreover, we have already begun reflecting results in the 2000–01 reports. The results of the evaluation will also provide an analytical basis to strengthen program effectiveness at the time of its renewal, scheduled for April 2004.

Project assessment and approval

5.184 Process. Although the terms of the Canada–community agreements may vary from one agreement to another, they all include the requirement to establish a development plan that details the community's priorities, an annual financial commitment for the five years of the agreement, and the appointment of a joint committee of community members and departmental representatives to review applications for funding.

5.185 The Department reviews the recommendations made by the joint committees, and sends each application to the Minister for approval. To date, the Department has provided funds almost exclusively as grants, subject to the receipt and acceptance of a recipient's audited financial statements, activity reports, and annual reports.

5.186 In general, applications for funding come from organizations that the Department funds year after year. According to the Canada-community agreements, a minimum of 20 percent of funding is to go to projects and the balance to financing the community organization's yearly activities.

5.187 **Development plans are not all completed.** The agreements call for the communities to submit five-year development plans (1999–2000 to 2003–04), including the strategies and general priorities to be considered in funding decisions. However, we found that the Department had not received development plans from 5 of the 15 communities with Canada-community agreements. Without a plan, the Department cannot ensure that its funding decisions support projects and activities that are aligned with community priorities.

5.188 **Weaknesses in project assessment.** In the Department's assessment of applications that we estimate accounted for $9 million (or 33 percent) of the $27 million in expenditures we audited for 2000–01, we found the following shortcomings:

- The general application forms were not filled out and the applications were incomplete.
- The applications did not state the expected results of the proposed projects, as required by the terms of the program. Furthermore, applications generally did not include a plan to evaluate the progress of activities toward goals or established objectives.
- There was nothing in the file to show that the Department had considered the eligibility criteria in deciding to fund activities. Internal audit raised the same issue in 36 percent of the cases it reviewed in 1999–2000 and 2000–01.

5.189 We also noted in most of the files that the level of funding was not adequately justified. The amounts approved varied from 27 percent to 100 percent of the amounts requested, with no rationale provided in the file.

5.190 The Department has not stipulated how to justify funding decisions, for example, on the basis of the applicant's cash requirements supported by its latest financial statements. In at least three cases, the applicant's cash assets exceeded the amount of funding granted, which puts into question the need for the funding.

5.191 Furthermore, where it granted less than the applicant had requested, the Department did not ask for a revised plan that reflected the lowered funding. It would be useful to the Department to know which activities and results the organizations planned to accomplish with less funding than expected, for better comparison of actual and expected results.

5.192 In most of the projects we reviewed, the application made no mention of attempts to obtain funding from other sources or the results of any attempts, as the program's terms and conditions require. That information could help the Department identify actual or potential duplication of government funding and adjust the amount it approved accordingly.

5.193 The Canada–community agreements contain a conflict-of-interest clause. However, in most of the files examined by internal audit, they found that there was nothing to provide assurance that members of the joint committee were not in a conflict of interest when the committee recommended applications to the Department for funding.

5.194 We also noted that the Department has not yet established service standards for the processing of applications for funding. For example, we noted that funding decisions usually took four to six months. In general, applicant organizations are not told of the funding decisions before June or July, which is a cause for concern and could have an adverse effect on activities planned for the year.

5.195 **Recommendation.** The Department should ensure that

- all applications are complete and meet the program's eligibility criteria
- the level of funding granted is adequately justified and, if less than requested, the potential effect on the expected results is documented.

Department's response. The Department accepts this recommendation. It created the National Grants and Contributions Review Committee in December 2000 for official languages support programs to provide ongoing auditing, in order to show greater compliance with the principles of due diligence in the review and approval of grants and contributions. On the basis of a review of all the files by a dedicated team, the Committee makes recommendations on all aspects of the processing of grant and contribution applications in order to ensure consistent interpretation of the program's terms, objectives, and criteria.

This Committee has already issued several administrative and program policy directives (for example, policy on the choice of funding mechanisms with a complexity assessment grid; directives on surpluses, significant cash balances, differed revenues, the organizations' fiscal period; procedures regarding the organization of recommendation files and the preparation of contribution agreements).

As part of an ongoing training strategy, workshops to reinforce the principles of due diligence in all aspects of processing files were offered to officers and managers responsible for official languages (fall 2000 and 2001) and training sessions on how to prepare a results-oriented application were offered to recipients (fall 2001). Officer and applicant guides were prepared for these workshops. Specific modules will be developed in response to other training needs.

Project and financial monitoring

5.196 **Lack of rigour in analyses of activity reports and financial statements.** Internal audit found in only 39 percent of the files it examined that the Department had reviewed either the activity reports or the annual reports supplied by organizations at the end of their projects. Furthermore, nothing indicated that at the end of the projects the Department had examined accomplishments, results achieved, or value added. This lack of rigour is even more serious in light of the fact that most of these organizations receive funding from the program year after year and that such information is essential for proper evaluation subsequently.

5.197 In many cases, we noted a lack of rigorous analysis of the financial statements submitted by the recipients. It appeared in those cases that the Department did not reconcile the grants declared in the statements with the funding it had provided, nor did it assess the possibility that there had been other sources of funding.

5.198 **Recommendation.** Where a recipient is required to submit financial statements and reports on results, the Department should compare more rigorously the actual results with the expected results to better evaluate the funding granted and to allow for better decision making in awarding funding in the future.

Department's response. The Department accepts this recommendation. The National Grants and Contributions Review Committee also requires that activity reports and financial statements submitted by client groups be subject to more rigorous analysis, and that this analysis be included in the file and be considered in all subsequent decisions. The 2002–03 applications will show progress in this regard because the applicant's guide used to train recipients in the fall of 2001 provides a sample of a results-oriented report.

5.199 **Several measures introduced to improve the program's management**. During the past year, the Department introduced several measures and initiatives to strengthen the management of official languages support programs and to emphasize managing for results. We noted that it provided training in the use of due diligence; developed a management and accountability framework and a risk-based audit framework; established a national committee to review all funding recommendations; and used a grid to assess project complexity and risk. Although it is too early to know how effective these measures will be, they should help address several of the problems our audit identified.

Conclusion

5.200 We found that the program needs significant improvements in its management framework, performance information, project assessment, and analysis of the results achieved. The program's objectives and expected results are stated in vague and general terms, and the program has not been evaluated since the *Official Languages Act* was amended in 1988. The Department of Canadian Heritage has not developed performance indicators, and its reports to Parliament mainly discuss program activities rather than the program's results. There were also problems in the Department's assessment of projects that accounted for 33 percent or $9 million of the $27.5 million in program expenditures we audited. Finally, analysis of the results achieved by projects lacked rigour.

5.201 In the past year, the Department of Canadian Heritage has introduced several measures to improve the management of the program. Although it is too soon to know how effective these measures will be, they should address several of the problems we identified.

Environment Canada and Natural Resources Canada—Contributions Made Under the Climate Change Action Fund

In brief

The Climate Change Action Fund (CCAF) is one of several initiatives undertaken by the government to help Canada meet its commitment under the Kyoto Protocol. That commitment was to reduce emissions of certain greenhouse gases in the period 2008 to 2012. For the years 1998 to 2001, funding was allocated to two departments: $40 million to Natural Resources Canada and $10 million to Environment Canada and approximately $30 million was spent in contributions.

A recent mid-term evaluation found that the CCAF was generally well-managed, although it recommended improvements in project monitoring and reporting of performance. We noted that the requirement for the Secretariat of the CCAF to report annually on its major achievements and its use of funds has not been fully respected. We found that in general, CCAF-supported projects were properly assessed and approved. We also found that there was adequate control over disbursements. However, the CCAF does not systematically track and compile information on the ongoing performance of the projects it funds.

Background

5.202 The Climate Change Action Fund (CCAF), announced in the 1998 Budget, is one of several federal initiatives to help Canada meet its Kyoto commitments. Canada, along with 160 other nations, negotiated the Kyoto Protocol in December 1997. In doing so, it agreed to reduce Canada's greenhouse gas emissions to six percent below 1990 levels between 2008 and 2012. The Federal Climate Change Secretariat, established in February 1998 and reporting to the deputy ministers of Natural Resources Canada (NRCan) and Environment Canada, is responsible for co-ordinating the federal government's policy commitments and programming on climate change and for managing the Fund.

5.203 Expenditures approved for the Climate Change Action Fund totalled $50 million a year for three years, beginning in April 1998. The funds were allocated for operating expenses as well as contributions to support private and public sector projects. The annual spending was allocated to NRCan ($40 million) and Environment Canada ($10 million). The funding was extended for another three years beginning in April 2001.

Focus of the audit

5.204 Our audit covered fiscal year 2000–01. The contribution payments made by the Fund in that year totalled about $30 million. The CCAF funds projects through several existing contribution programs in other departments and agencies, so we also looked at its accountability framework.

5.205 The objective of the audit was to determine whether the departments had adequate control over contributions made by the CCAF. Further details on the audit can be found in About the Audits at the end of the chapter.

Observations and Recommendations

Program design

5.206 **Program objectives.** We expected NRCan and Environment Canada would ensure that the program was designed to achieve results, manage risks, ensure due diligence in spending, and provide accountability for funds spent.

5.207 We found that in general, the program's objectives are clearly stated. The objectives are to encourage and undertake programs and activities that will contribute to Canada's ability to combat climate change and meet its climate change commitments under the Kyoto Protocol. The principles governing the CCAF are spelled out in an evaluation and accountability framework.

5.208 **Roles and responsibilities.** We found that the responsibilities under the Fund are reasonably clear, although somewhat complicated. Two departments, Environment Canada and Natural Resources Canada, have the lead responsibility and accountability for the program. They have delegated authority to the Federal Climate Change Secretariat to pay for climate change initiatives from the Fund. The Secretariat has created four separate components, called blocks, to deliver the CCAF program: Public Education and Outreach; Technology Early Action Measures; Foundation Analysis; and Science, Impacts and Adaptation. Most of these blocks, in turn, partner with other programs to deliver projects.

5.209 The Secretariat is represented on all the blocks' management committees. All the blocks have business plans outlining their responsibilities. The Secretariat is supposed to co-ordinate the overall review of the activities that all blocks of the CCAF carry out.

5.210 **There is no formal risk management strategy.** Risk management is intended to strengthen management practices, decision making, and priority setting. At the time of our audit, the program did not have a formal risk management strategy that would identify risks in relation to the results of the program and lead to improved controls. The Secretariat informed us that it mitigates risk by its involvement in selection committees and core assistant deputy minister (ADM) committees. In addition, two recent audits dealt with aspects of program risk. The Secretariat also recently developed a risk-based audit framework for recipients of CCAF contributions. Nevertheless, we encourage management to conduct a comprehensive risk assessment.

Program performance

5.211 **Mid-term evaluation recently completed.** We expected that CCAF management would know whether it is achieving expected results and would make reasonable efforts to harmonize and co-ordinate its activities with other organizations delivering similar programs.

5.212 A mid-term evaluation was recently completed of all four blocks of the CCAF program. The evaluation addressed all the required evaluation issues except the program's long-term impacts, since it was only a mid-term evaluation conducted for the first three years of operation. An assessment of the program's long-term impact in reducing greenhouse gas emissions will be undertaken in the future.

5.213 The following are some of the main findings of the evaluations:

- Public Education and Outreach has been run and managed well and has successfully funded a variety of projects. The report also suggested that it should adopt an approach that would help successful local projects move to the national level.
- Most stakeholders were confident that projects and activities of the Technology Early Action Measures block would likely lead to the expected outcomes and impacts. The report recommended that it target industry sectors that have the greatest potential for reducing greenhouse gas emissions.
- Science, Impacts and Adaptation objectives were, and remain, relevant to the federal government's climate change agenda.
- The evaluation concluded that overall, the Foundation Analysis block was successful in meeting its objectives and was generally well-managed. However, the report recommended that the Secretariat play an active role in monitoring progress and that performance targets and means to monitor progress be established.

5.214 Last year an internal audit by Natural Resources Canada found that the CCAF's selection and monitoring of projects as well as the payment conditions in the contribution agreements could be stronger. However, it found the payment process adequate.

5.215 In addition, the Secretariat's accountability was audited in 2001 although the audit focussed only on its relationship with NRCan. The audit concluded that the CCAF has many well-managed elements and its decentralized business model makes effective use of existing administrative procedures and expertise from across federal departments. The audit identified a number of needed improvements: in service standards, project monitoring and reporting by different partners, financial and progress reporting to the Secretariat, and measurement of the Secretariat's performance.

5.216 **Annual reporting requirements were not fully met.** The Secretariat is supposed to provide an annual report to the ministers of the Environment and of Natural Resources on the CCAF's major achievements and its use of appropriated funds. We found that no such reports have been provided. In our view, the annual report is a key accountability document, since the funding is distributed to various programs in several departments and agencies.

5.217 Management informed us that it has presented annual reports to the Conference of the Parties (CoP) of the United Nations Framework Convention on Climate Change. In our view, these reports are primarily detailed descriptions of the projects funded by the CCAF, with some project-level results; they do not fully meet the annual reporting required of the program.

5.218 **Performance reporting to Parliament is fragmented, focussed on outputs.** We reviewed the departmental performance reports and reports on plans and priorities of both NRCan and Environment Canada for 1999 and 2000, and we found few references to the CCAF. While both departments provide a lot of information on climate change, it is dispersed throughout their reports. The October 2001 Report of the Commissioner of the Environment and Sustainable Development was also concerned about fragmented performance reporting to Parliament. Management states that Treasury Board's requirement to report by business line and now by strategic outcomes limits the ability of both departments to report the Fund's accomplishments in a comprehensive way. In our view, the departments should consider reporting in a consolidated way on the CCAF in the Estimates documents.

5.219 Where the CCAF's achievements are discussed, they are presented primarily as outputs and activities; there is little measurement of results achieved. We recognize that it is too early to expect performance information on the overall impact of a program that, like this one, is mainly designed to help meet commitments between 2008 and 2012. Management informed us that a mechanism to verify results is being developed, as one of the important objectives of Technology Early Action Measures. Management also indicated that very few projects have been completed. In our view, management should continue to work on reporting progress toward its objectives, given that it is too early to report on the program's overall impact.

5.220 Under the revised Treasury Board Policy on Transfer Payments effective June 2000, the specific objectives and results planned for grant and contribution programs over $5 million must be stated clearly in the department's report on plans and priorities together with milestones for achievement. We noted that in both departments' 2001–02 reports, summary information on the CCAF's objectives and planned results was provided.

5.221 **Recommendation.** Management of the Climate Change Action Fund should do the following:

- report annually to the ministers of the Environment and of Natural Resources on the program's major achievements and the use of appropriated funds; and
- present clear and consolidated information to Parliament on the performance of the program.

Management's response. CCAF management recognizes the need to present clear and consolidated information to ministers, Parliament, and the public on the performance of the CCAF. In the interests of efficiency, past requirements for annual reporting to ministers had been combined with other annual reporting requirements, such as the compendia prepared for CoP 5 and CoP 6 and the recent report *Responding to the Challenge: The Climate Change Action Fund (CCAF) 1998–2001 Report*. For 2001–02 and subsequent years, a detailed, integrated, stand-alone annual report will be prepared covering all activities under the CCAF in terms of project spending and results achieved. The CCAF will also be addressed in a more consolidated way in future Estimates documents.

Project assessment and approval

5.222 Departments and agencies that deliver the program generally use their own contribution program terms and conditions. Nevertheless, the CCAF's program authority requires that in verifying eligibility for funding by the CCAF, delivery agents must consider the Fund's overall objectives. They must also look for opportunities to leverage funds and share costs wherever possible with the provinces and the private sector, set concrete milestones and expected results, and ensure that the approval process is transparent.

More diligence needed in approving projects

5.223 We found that for the most part, the Secretariat satisfies itself that each program component exercises due diligence in approving projects. We found some problems in areas of project management, such as assessing project proposals, determining eligibility, documenting key project assessment decisions, and managing repayable contributions. (Our sample did not cover contributions managed by the Foundation Analysis block because total spending in 2000–01 was not significant.)

5.224 **Some problems with verifying eligibility and assessing project proposals.** At the time of our audit, to be eligible for funding through Technology Early Action Measures, project proponents had to be members of a climate change association. Membership in such an association demonstrates the applicant's commitment to climate change issues. In 14 of 20 cases we looked at, Technology Early Action Measures projects were approved although the applicants did not have the required membership.

5.225 Two projects, one under Public Education and Outreach and one under Science, Impacts and Adaptation, were approved without assessing the proponents' capabilities to carry out the projects. In both cases, management informed us that the project proponent had carried out another project for them and was known to management. In our opinion, adequate documentation should have been included in the project files.

5.226 During the period under review, some commercial projects were approved by Technology Early Action Measures without a formal marketing assessment. Although this is not a criterion for eligibility, a more structured approach to evaluating commercial projects that includes review of a marketing or business plan would be appropriate. The mid-term evaluation of the CCAF raised the same point. Management has indicated that delivery agents who did not have market assessment tools later received training to deal with commercial projects.

5.227 **Key documentation not found in many files.** We found that project documentation varied greatly among the different components of the CCAF. Files on Public Education and Outreach projects and Science, Impacts and Adaptation projects contained all key documents. The Technology Early Action Measures project files contained the standard project recommendation form, documenting the project assessment. However, we found that each project file we examined from Technology Early Action Measures lacked one or more pertinent documents such as applications, contribution agreements, approval decisions, progress reports, and final reports. Technology Early Action Measures management told us that this was because the projects are managed by delivery agents from participating departments and all the relevant documents are in the delivery agents' project files. They also informed us that in the future it will attempt to keep complete documentation on file, especially the contribution agreements. Having all the relevant documents at the block level is critical for the Secretariat to determine whether the projects are meeting CCAF objectives and to assess their progress.

5.228 **Problems in determining repayment terms for contributions.** The Policy on Transfer Payments requires departments to ensure that where a contribution to a business is intended to allow the business to generate profits or increase its value, the business must repay the contribution or share the resulting financial benefits with the government, commensurate with its sharing of the risks.

5.229 According to eligibility criteria for funding by Technology Early Action Measures, contributions to all commercial projects—those where profit is expected within three years—are repayable. We found that some of these projects were approved by Technology Early Action Measures before the terms, timing, and basis of repayment were determined.

5.230 Both Technology Early Action Measures management and delivery agents are supposed to ensure that the recipients of a repayable contribution declare the status of any previous debts to the federal government before approving the contribution. We found that this was not done for some recipients.

5.231 **Contracts were used where contribution agreements were appropriate.** We found that four projects were handled as contracts instead of contributions by two delivery agents. The projects in question had all the characteristics of contributions: they were subject to the same eligibility criteria and went through the same project assessment and selection process; their costs were shared with private firms; the government was not getting any goods or services in return; and above all, some of the funds were repayable. In our view, these projects should have been handled as contributions and not contracts. In deciding whether contracts or contribution agreements should be used, delivery agents should ensure that they characterize appropriately the nature of the contractual arrangement and comply with applicable Treasury Board policies on contracting and on transfer payments.

5.232 Recommendation. The Climate Change Action Fund management should ensure the following:

- that each funded project meets all program criteria;
- that project files at the block level contain all required documentation;
- that the terms, basis, and timing of repayments are specified and the status of any outstanding debts to the Crown is known before repayable contributions are approved; and
- that delivery agents use contracts and contributions appropriately.

Management's response. To minimize overhead costs, the CCAF builds on existing federal program infrastructure. CCAF management recognizes the need to ensure that its delivery agents fully respect program criteria, use appropriate financial instruments, and maintain complete files. Departments and project selection committees will be directed to take greater care in making sure that project proposals meet all program criteria, repayment considerations are in order, and appropriate financial instruments are used. Effective January 1, 2002 all CCAF blocks will maintain centrally a complete set of project files, each containing all required documentation.

Project and financial monitoring

5.233 Need for more systematic and meaningful monitoring of results. The Secretariat is supposed to receive quarterly progress reports on projects administered by the Fund's blocks and delivery agents. While a variety of reporting mechanisms exist, we found no formal or systematic reporting of project results to the Secretariat. The required progress reports are to include projects undertaken, deliverables and milestones achieved, and funds leveraged, so the Secretariat can know whether project performance is on track. We found that the Secretariat does not systematically track and compile results and milestones achieved.

5.234 However, last year's internal audit of the CCAF found that delivery agents monitor the projects they administer. The internal audit also noted that progress reports on 6 of the 26 projects it reviewed were late. The audit report recommended that the CCAF ensure that delivery agents provide the program blocks with regular progress reports to demonstrate the progress of CCAF-funded projects and to promote greater accountability.

5.235 Financial control of disbursements. We found that CCAF management had properly approved all disbursements transferred to delivery agents. An internal audit conducted by Natural Resources Canada also concluded that there were appropriate controls on payments. It also found there was evidence on file to demonstrate that claims were reviewed before payment, no payments were made before agreements were signed, and signing authorities were respected.

5.236 Financial monitoring by the Secretariat can be improved. We found that the program blocks do not provide the Secretariat with the required quarterly financial reports. The Secretariat has received some reports from them as needed. To be useful, financial reporting must be not only accurate, as we found it, but also regular and systematic.

5.237 **Recommendation.** CCAF management and the program components should track the results of funded projects in a formal and systematic way to ensure that project goals are met.

Management's response. To minimize the administrative burden on CCAF delivery agents, CCAF management in the past has issued calls for financial and progress reports on an as-needed basis. CCAF management agrees that a more formal and systematic approach should be implemented to ensure that program goals are met. Quarterly financial and progress reports will be formally requested from each CCAF block, beginning with a report due January 31, 2002 covering the third quarter of 2001–02.

Conclusion

5.238 A recent mid-term evaluation found that the CCAF was generally well-managed, although it recommended improvements in monitoring and reporting performance. We noted that the requirement for the Secretariat of the CCAF to report annually on its major achievements and its use of funds has not been fully respected. We found that in general, CCAF-supported projects were properly assessed and approved. We also found that there was adequate control over disbursements. However, the CCAF does not systematically track and compile information on the ongoing performance of the projects it funds.

Section 7

Solicitor General Canada— First Nations Policing Program

In brief The purpose of the First Nations Policing Policy is to help improve social order, public security, and personal safety in First Nations and Inuit communities by establishing and maintaining police services that are professional, effective, and responsive to the communities' needs. The federal government contributes 52 percent of the costs of these police services, through contribution agreements negotiated among it, provincial and territorial governments, and the First Nations communities. Our audit covers the federal expenditures on the program in 1999–2000, a total of $56 million.

At 31 March 2000, the program was providing funds for more than 800 police officers in 317 First Nations communities, covering about 62 percent of the eligible First Nations population. Since 1995, the number of signed agreements has more than doubled, to 123. We noted that the program objectives are clear. However, one of the objectives—to provide 80 percent of the on-reserve population with local policing by 1995—has not yet been achieved and the Department needs to estimate the additional funding required to reach this coverage. While we noted that the design of the program is sound, we found that significant improvement is required in assessing the police services that First Nations communities need. We found some failures to comply with program authorities. We estimate that about $3 million of spending was not properly supported. We found that of advance payments that were unspent by year-end and carried forward to the next fiscal year, an estimated $1.8 million exceeded the authorized limit. Where Royal Canadian Mounted Police (RCMP) services were contracted, the agreed numbers of RCMP officers were not always provided.

Background

5.239 The First Nations Policing Policy was approved in 1991. In 1992 the Department of Indian Affairs and Northern Development transferred its responsibilities for the First Nations Policing Program to the Department of the Solicitor General. The program provides funding for police services on reserves and certain federal Crown lands, through contribution agreements among the federal government, provincial or territorial governments, and First Nations and Inuit communities. The federal government provides 52 percent of the funding, and the province or territory 48 percent, for police services that are to be professional, effective, culturally appropriate, and accountable to the First Nations and Inuit communities they serve.

5.240 The objectives of the First Nations Policing Program, originally stated in the 1991 terms and conditions approved for the program, are the following:

- to provide 80 percent of the on-reserve First Nations population with access to First Nations policing services by 1995–96 (revised to 2000–01);
- to provide on-reserve First Nations communities with access to a level of service equal to that enjoyed by similar non-First Nations communities in the region; and
- to increase the satisfaction of on-reserve First Nations communities with the policing services provided to them.

Focus of the audit

5.241 Our objective was to determine whether the Department had adequate control over the First Nations Policing Program. Our audit covered the fiscal year 1999–2000, when total funding for the program was $56 million. That amount represented 123 agreements (including 53 self-administered police services that cost $35 million) and covered about 62 percent of the on-reserve population.

5.242 Further details can be found in About the Audits at the end of the chapter.

Observations and Recommendations

Program design

5.243 **Program objectives are clear.** The defined need for the program is to expand and improve the level and quality of First Nations policing services. In our view, the program objectives and expected results that we have already described are relatively clear. The federal share of funding is set at 52 percent.

5.244 **Program management.** The mechanisms to ensure accountability for the use of federal contribution funds include the agreements themselves; the requirement for audited financial statements; regular compliance audits; and monitoring and follow-up of action to address audit observations. These mechanisms constitute a relatively sound management framework for a contribution program used to fund ongoing police services.

5.245 The program has a total staff of 28, including regional staff, and an annual budget of $3.3 million for operations and maintenance. We noted that the staff complement has remained relatively constant since 1995, while the number of agreements has more than doubled. Based on our observations of the financial control over this program, this suggests that its resource levels and financial management capacity will need to be reviewed to ensure effective control over funding.

5.246 **There is no formal risk management strategy.** Risk management is designed to strengthen management practices, decision making, and priority setting. A risk management strategy helps in identifying, analyzing, assessing, monitoring, and controlling risks in managing contributions. It also helps to prevent unsatisfactory or unintended outcomes. During our audit, management documented its management practices. However, it has not developed a formal risk management strategy to ensure that it manages risks properly.

Program performance

5.247 A program evaluation in 1995 assessed the program's relevance and partially assessed its success and cost effectiveness. It also assessed to what extent the program was being implemented as planned. Among other things, the evaluation found the following:

- The program was being implemented in accordance with the First Nations Policing Policy.
- Anecdotal evidence suggested that communities were either more satisfied than before or saw no change.
- While there was substantial progress toward achieving the objectives of both the policy and the program, the objective of 80 percent coverage by First Nations police had not been achieved.
- The evaluation raised some concerns, for example, that the agreements seemed to "yield an enhanced policing service" compared with the service available to similar communities that were not First Nations; and not all items were funded, or funded the same way, across agreements.

The Department advised us that a program evaluation is presently scheduled for 2004–05.

5.248 In 1996, the Department estimated that it would need $56 million a year by 2000–01 to provide First Nations policing to 80 percent of the total on-reserve population. By 1999–2000 the cost of the program had already reached $56 million, but the program covered only about 62 percent of the eligible population. At the time of our audit, the Department was reviewing the estimated cost of extending coverage to 80 percent of the eligible First Nations population. In our view, it will be important to know why the funding provided to achieve 80 percent coverage achieved only 62 percent coverage. The Department advised us that it is assessing the trade-offs between enhancing police services funded under existing agreements and negotiating new agreements. This assessment should contribute to the planned evaluation of the program and to a more accurate estimate of the program's eventual cost.

5.249 **Reporting to Parliament.** We reviewed the Department's 1999–2000 *Report on Plans and Priorities* and its *Performance Report*. We found that the Department's *Performance Report* presented its accomplishments for each key results commitment in its *Report on Plans and Priorities*. However, it was not easy to make a clear comparison between what was accomplished and what had been planned. For example, the Department reported as accomplishments the number of new policing agreements being negotiated, but did not compare it with its expected result of expanding First Nations policing coverage to between 75 and 80 percent of the eligible First Nations population. We noted that in its 2001–02 *Report on Plans and Priorities*, the Department responded well to the requirements of the new Policy on Transfer Payments.

5.250 **Recommendation.** The Department should develop a reliable cost estimate of the eventual cost of achieving all of the program's objectives.

Department's response. The Department agrees with this recommendation.

The Department has initiated discussions with First Nations organizations and with provinces on the need to balance the twin objectives of achieving greater coverage under the First Nations Policing Program (FNPP) and of ensuring the ongoing adequacy and effectiveness of existing FNPP policy services over time. These discussions will be helpful in estimating the desired level of service and related costs.

The Department will develop options that will address the Program's coverage and capacity goals and related resources requirements.

Project assessment and approval

5.251 Under the terms and conditions of the program, funding is to be consistent with the costs of policing in communities in the region with similar conditions. Levels of policing service are to be determined on the basis of the following:

- demographic characteristics of the population to be served;
- size and nature of the geographical areas to be covered and their degree of isolation;
- the police workload as determined by reactive and proactive measures; and
- a clear statement of the goals of the agreement and a plan for evaluating their achievement.

5.252 What is unique about this program is that while it is funded through contribution agreements, it is based on negotiated tripartite agreements among the federal government, the province or territory, and the First Nations community. The level of services negotiated by the parties has a major impact on the funding provided through the contribution agreement. Generally, agreements are for three to five years and set the funding levels for each year. The agreements can take more than a year to negotiate and sometimes five to six additional months to approve, which often results in several short-term extensions.

5.253 **Lack of adequate support for funding decisions.** We found that the analysis supporting the level of service and the related level of funding was incomplete in 10 of the 16 self-administered agreements we audited. This includes agreements renewed with funding increases that were not clearly or properly justified, as the program's terms and conditions require. For example, the Department had no information on comparisons with similar non-First Nations communities or no documented rationale for why funding levels exceeded those in comparable communities. While the level of crime is often cited to explain increases in funding, in most cases we did not find analyses of caseloads, by police officer, to justify the numbers of police officers funded. Of the $35 million paid by the federal government through self-administered contribution agreements in 1999–2000, we estimate that about $3 million (or 8.6 percent) had not been properly justified under the program's criteria.

5.254 **Unclear agreement terms.** Funding is provided through contribution agreements negotiated between three parties—two funders and the recipient. While we recognize that no two agreements will be exactly the same because they are negotiated, we expected to see in all of them basic requirements to conform with program authorities and to ensure accountability for performance. However, we found that the following elements were missing from the 16 self-administered contribution agreements we audited:

- **Number of police officers.** Five agreements did not include a clause specifying the minimum number of police officers that must constitute the police force and for which funding was provided.
- **Recovery of overpayments or unused advances.** We found nine agreements that did not have clauses on recovery of overpayments if total funding provided should exceed eligible actual expenditures. This contravenes the Treasury Board's policy on transfer payments.
- **Eligible costs.** Almost all agreements lacked clauses that defined eligible policing costs. For example, under the program's terms and conditions, minor capital expenditures are eligible. Yet the agreements do not refer to minor capital expenditures, define them, or say which are eligible and not eligible.

5.255 **Agreements approved without proper authority.** One important control over the spending of public funds is the formal approval of contribution agreements. The Solicitor General has delegated to specific officials of the Department the signing authority for contributions below $1 million. We found three agreements representing total federal funding of $2.6 million that were signed by someone to whom authority had not been formally delegated.

5.256 **Recommendation.** The Department should properly support the level of funding provided under each contribution agreement and ensure that all contribution agreements are properly approved and include all required elements.

Department's response. The Department agrees with this recommendation.

There are many individual factors that enter into the tripartite negotiation process. For example, some police services are located close to large urban centres, while others involve remote communities policed under a regional police service model. The degree of criminal activity in a community, geographic location, and the costs associated with policing in a remote area can all influence the level of funding provided. The Department has undertaken analysis at the national and regional level of the factors related to effective First Nations policing. It will ensure that the justification to support the level of funding provided in individual agreements is properly documented, and other requirements are met.

Unlike many contribution programs that fund one-time projects or initiatives, the FNPP provides cost-shared resources for essential, and ongoing, police services, with the bulk of the program dollars actually flowing to police salaries. Certain flexibilities that are required for the effective management of these ongoing police services. The Department will renew the terms and conditions of the First Nations Policing Program and seek applicable exemptions to the Transfer Payment Policy by December 31, 2003.

Project and financial monitoring

5.257 The cash management provisions of the government's policy on transfer payments allows contributions to be paid in advance as the recipient's cash flow requirements dictate. The program's terms and conditions require a 10 percent holdback, to be released on receipt of the final claim provided that the recipient has met the terms and conditions of the contribution agreement. Agreements require that recipients submit audited financial statements within five months after year-end. Any funding unspent at year-end can be carried over to the next year for police service costs, as the individual agreements may provide. Some agreements require written approval by the federal and the provincial governments for any carry-over above a certain percentage of annual funding (generally 5 percent).

5.258 **Failures to comply with authorities.** We found instances where the Department acted outside the authority of the program's terms and conditions and outside the cash management requirements of the Treasury Board's transfer payment policy. The Department tells us it will ask the Treasury Board to approve revised terms and conditions that will better reflect changing realities and that will incorporate the flexibility needed for optimal administration. Nonetheless, the following are examples we found where the Department did not comply with existing authorities:

- **Quarterly advance payments instead of monthly.** The transfer payment policy allows for quarterly or monthly advance payments, according to the amount of the contribution. In this program, the Department made advance payments in equal quarterly instalments. In 15 of the 16 self-administered agreements we audited, the amount of the contribution dictated that only monthly advance payments were allowed under the transfer payment policy.
- **Advances not based on cash requirements.** The policy on transfer payments requires that the amount of each advance payment be based on a cash flow forecast from the recipient and that it take into account any advance payments issued and interest earned on them. Also, the policy requires that balances carried over to the next fiscal year be limited to the cash requirement for the month of April. The Department complied with neither of these requirements in most cases. We estimate that about $1.8 million of advances unspent at year-end exceeded the authorized levels for carry-overs and were not recovered.

5.259 **Funding provided for ineligible costs.** Of the $35 million paid by the federal government under the self-administered contribution agreements in 1999–2000, we estimate that about $0.8 million (or 2.3 percent) was for expenses that were not eligible. They included items such as major capital expenditures (specifically, funding for police stations), the previous year's deficits, and other ineligible expenses identified by audits the Department conducted of some agreements that year. We found that the Department has paid for capital infrastructure through a number of agreements, in various ways. For example, it has reimbursed loans and interest to finance construction of police stations or major repairs to them, provided fixed amounts for capital purposes each year, and allowed surpluses from the operating budgets to be used for capital spending. Spending on infrastructure such as buildings (police stations), houses, and roads is not an eligible expenditure under this program. As mentioned earlier, the agreements do not stipulate which costs are eligible and which are not; they mention only that funding is to be used for policing costs.

5.260 While the Department told us that the mandate to fund capital infrastructure for policing services had not been transferred from Indian and Northern Affairs Canada (INAC), departmental correspondence indicates that INAC does not have the same understanding. This needs to be clarified and the Department has told us it is addressing the issue at present. There is also a risk that some rents are reimbursed for the use of police stations whose construction INAC might have paid for already.

5.261 **Retroactive payments made for which no cost had been incurred.** Payments are made retroactively when a new agreement that provides increased funding could not be negotiated before the term of the existing agreement ended. For example, in one case, an interim agreement was approved with the same terms until a new agreement could be reached. When a new agreement was signed it increased the number of police officers, retroactive to six months before. The Department had not verified that the additional police officers had actually been hired and the costs incurred when it paid the recipient the increased funding. We noted that at 31 March 2000 the recipient had a surplus that it was allowed to keep.

5.262 **Project evaluation and audit.** Ten of the agreements we examined stated that an evaluation could be conducted in the last year of the agreement. Six of the agreements had been evaluated. These evaluations provided feedback on the effectiveness of the police services. We noted that program management took action where required to ensure that any necessary improvements were made.

5.263 All but one of the agreements we examined had an audit clause. Audits are conducted regularly, at least once every five years for significant agreements, and management follows up on the audit recommendations. In the one exception, an audit had been scheduled for 2000 but the community refused the auditors access. At 30 April 2001 the issue was still unresolved, but the Department has since advised us that it plans to conduct an audit in 2001–02. We also noted that there has been no internal audit of the program's management.

5.264 **Monitoring.** The program's regional managers are responsible for ensuring that communities receive the police services the Department has funded. This is done in many ways: visiting the communities; participating in meetings; obtaining activity reports; and holding discussions with band council, police board members, and chiefs of police and officers. We did not assess how well this is done. However, we noted that the Department does not always request and obtain performance or activity reports for all agreements. As a consequence, it does not have complete information on the actual levels of service, that is, the number of police officers in service and the service they provide.

5.265 At the time of our audit, the Department had neither the consistent and reliable data nor the key indicators it needs to measure the program's performance. It has recognized the difficulty of getting consistent and reliable data to measure the program's performance. At the time of our audit, the Department had undertaken a number of initiatives to assess both the efficiency and the effectiveness of First Nations policing in order to ensure that funds are administered appropriately and the policy objectives met. It was too early, however, to assess the results of these initiatives.

5.266 Where the RCMP continues to provide police services under community tripartite agreements (CTA), the three parties agree each year on the number of police officers needed in the community. For 1999–2000, a total of 171 RCMP officers were contracted for but only 148 (14 percent fewer) were actually provided and paid for. This means that the agreed level of service was not always provided in some communities. For example, in one province there were 85 RCMP police officers, 16 percent fewer than the 101 contracted for. According to RCMP officials, the situation improved in 2000–01.

5.267 **Recommendation.** The Department should seek the Treasury Board's clarification on who is responsible for federal funding of infrastructure for police services and should co-ordinate with Indian and Northern Affairs Canada, as appropriate, to ensure that any funding for major capital expenditures is provided in accordance with proper authorities. The Department should also improve the monitoring of projects' performance and its financial control over projects.

Department's response. The Department agrees that the mandate, authority and funding for infrastructure for police services needs to be clarified. The Department has already initiated discussions with the Treasury Board Secretariat and other central agencies, with PWGSC, INAC, the RCMP, and the provinces, and plans to continue these discussions.

In terms of improving project performance monitoring, the Department recognizes the importance of performance indicators, notwithstanding that such indicators are preliminary at best even in "mainstream" policing contexts. A number of initiatives are currently under way, including research on effectiveness, and are expected to provide a basis for developing some preliminary performance indicators for First Nations policing services.

The Department acknowledges that the rapid growth in the number of agreements—a reflection of strong community interest in enhanced public safety—has put pressures on departmental program management resources.

Discussions are under way with provinces on the potential for co-ordinating both financial and operational audits. The five-year audit plan was recently expanded to include audits of the RCMP-delivered community tripartite agreements. The in-house capacity for analyzing and monitoring financial statements will be strengthened through the establishment of an additional financial resource. As well, generic financial clauses are being developed that will be included in the self-administered policing agreements, where feasible, as they are renewed.

Conclusion

5.268 At 31 March 2000, the program was providing funds for more than 800 police officers in 317 First Nations communities, covering about 62 percent of the eligible First Nations population. Since 1995, the number of signed agreements has more than doubled, to 123. We noted that the program's objectives are clear. However, one of the objectives—to provide 80 percent of the on-reserve population with local policing by 1995—had not yet been achieved. The Department needs to estimate the additional funding it requires to reach this coverage. While we noted that the design of the management framework is sound, we found that significant improvement is required in assessing the police services that First Nations communities need. We found some failures to comply with program authorities. We estimate that about $3 million of spending was not properly supported. We found that of advance payments that remained unspent by year-end and were carried forward to the next fiscal year, an estimated $1.8 million exceeded the authorized limit. Where RCMP services were contracted, the agreed numbers of RCMP officers were not always provided.

Western Economic Diversification Canada—Community Futures Program

In brief The Community Futures program was established by Human Resources Development Canada in 1986 under the Canadian Jobs Strategy. Its purpose was to create Community Futures Development Corporations (CFDCs) that would diversify the Canadian rural economy by creating or maintaining jobs in new or existing businesses. They would do this by delivering a range of services in the areas of community economic development, business assistance, and access to capital.

Community Futures was transferred to Western Economic Diversification Canada (WD) in 1995 and that Department entered new contribution agreements with the CFDCs to reflect the change. WD provides the 90 CFDCs with a total of roughly $21 million in operating funds each year, which they use for accommodation, salaries, materiel, and legal obligations. Since taking over the program, WD has provided $72 million to CFDCs in investment funds, which are used to make loans.

We found that the program terms and conditions are well designed, setting a clear framework within which CFDCs are responsible for their operations and accountable to WD. The Department's monitoring of the performance of CFDCs relies heavily on information whose accuracy it does not systematically assess. Although WD is making improvements, its monitoring procedures do not yet enable it to assess adequately whether CFDCs are complying with the program's terms and conditions. In our view, Parliament does not receive enough information on the results of the Community Futures program.

Background

5.269 The federal government created Western Economic Diversification (WD) in 1987 to develop and diversify the economy of Western Canada, to co-ordinate federal economic activities in the West, and to reflect Western interests in national decision making. The Department offers services to every community in Western Canada through a variety of programs, such as the Western Canada Business Service Network, Women's Enterprise Initiatives, Canada Business Service Centres, and the Community Futures Development Corporations (CFDCs).

5.270 The Community Futures program was started by Human Resources Development Canada in 1986 as part of the Canadian Jobs Strategy but was transferred to WD in 1995. The program provides the CFDCs with roughly $20.7 million a year in operating funds. Since taking over the program, WD has provided $72 million in investment funds to the CFDCs.

WD contributions to CFDC investment funds are conditionally repayable; operating funds are non-repayable. Upon dissolution of a CFDC, once outstanding liabilities are settled, all remaining investment funds must be returned to WD.

5.271 The CFDCs are non-profit corporations responsible for a variety of community-focussed activities that support economic development in designated rural areas. They help communities to develop and diversify through the following activities:

- Strategic community planning—working with communities to assess local problems; establish objectives; plan and implement strategies to develop human, institutional, and physical infrastructures; and support entrepreneurism, employment, and the economy.
- Business services—delivering a range of business, counselling, and information services to small and medium-sized enterprises.
- Access to capital—providing capital to assist existing businesses or to help entrepreneurs create new businesses.

5.272 The CFDCs use their operating funds from WD for community economic development, business services marketing, and administration. They use their investment funds to make loans at no less than two percent interest plus prime, to guarantee loans, and to provide share capital to eligible businesses. Each CFDC operates with a small core staff of officers and a volunteer board of directors drawn from the local community.

Focus of the audit

5.273 Our audit covered the operations of the Community Futures program during 2000–01. Our objective was to determine whether WD had adequate control over this program.

5.274 Further details can be found in About the Audits at the end of the chapter.

Observations and Recommendations

Program design

5.275 The terms and conditions of the program provide a good framework to hold CFDCs accountable for their use of public funds. They require WD to ensure that no CFDC receives more than $300,000 each year for operating costs (with an additional $20,000 to CFDCs in remote areas for travel costs). No CFDC is to receive more than $6 million in investment funds over its life.

5.276 CFDCs are to develop and diversify the economy by loaning investment funds to help create new businesses and stabilize or expand existing businesses, primarily outside metropolitan areas. The program's terms and conditions set a number of rules for CFDC lending practices, in particular the following:

- CFDCs are not allowed to make any loan of over $125,000 to any business.

- They may provide loans only to businesses that have a reasonable expectation of economic viability and whose principals have an appropriate level of financial involvement.
- CFDCs may not use investment funds from WD to make grants, contributions, or forgivable loans and they must avoid conflicts of interest.
- They cannot make a loan until the applicant provides evidence that it has explored all other reasonably available avenues of financial assistance.

5.277 CFDCs must deposit and maintain contribution funds in two separate accounts: operating costs and investment fund capitalization costs. CFDCs can collaborate with each other or with private sector lending institutions to establish and administer investment funds. They must also complete annual business plans, periodic activity reports, and annual audits of their operations.

5.278 **Risk assessment.** WD has started acting on the results of a quality assurance review that identified risks in grant and contribution programs and related best practices. It has incorporated risk assessment in its funding procedures. The risk assessment considers factors such as the amount of funding, complexity of the project, number of funders, public profile, previous history, financial statements, and duration of the project.

Program performance

5.279 Most of the available information on the performance of the Community Futures program comes directly from the individual CFDCs. The Department has not conducted an evaluation of the program, nor has it carried out an internal audit.

5.280 When Community Futures was transferred to it, WD entered new contribution agreements with the CFDCs to emphasize its own program objectives. Its contribution agreements with the CFDCs set out performance targets and performance reporting requirements. However, our review of CFDC performance reports showed that they usually do not include all the performance information stipulated in the agreements, particularly on CFDC assistance to Aboriginal clients and disabled clients.

5.281 The agreements require CFDCs to provide business plans, activity reports, and audited financial statements as a basis for WD's funding decisions. Performance reports by CFDCs usually contain management assertions on their performance. But WD has no procedures for assessing the accuracy of these assertions or auditing the results claimed, for example, numbers of jobs created or maintained by CFDC activities. One CFDC indicated in its annual report that its lending activities were responsible for creating or maintaining hundreds of jobs with a payroll of tens of millions of dollars over 10 years. Another CFDC reported dozens of jobs created and maintained through a relatively small loan and even less invested by the borrower. WD should have some assurance that such results can be fully attributed to its funding.

5.282 **Reporting to Parliament.** The department's performance report includes information on the leading activities of the CFDCs—number and value of loans—as well as job creation and maintenance numbers reported by

CFDCs to WD. However, WD provides little information that links the results of these lending activities to its objectives or strategic initiatives. The Department's 2001–02 *Report on Plans and Priorities* indicates two planned results for the community futures program. We encourage the Department to add and report on outcomes and milestones in future reports.

5.283 **Recommendation.** The Department should do the following:

- establish procedures to assess the accuracy and validity of information that CFDCs provide on their performance;
- provide a complete overview of the program's performance in its reports to Parliament; and
- consider conducting a program evaluation and an internal audit of the program.

Department's response. The Department agrees.

- WD will strengthen procedures to assess the accuracy and validity of CFDC performance information provided.
- The observations reflect the inherent difficulty of performance measurement in economic development programs where results are achieved over a long period of time. Efforts to improve performance reporting are ongoing. WD will expand its reporting on the Community Futures program in its 2002–03 *Performance Report*.
- The terms and conditions of the Community Futures program call for an evaluation by May 2003. WD will initiate the evaluation in April 2002, based on a results-based management and accountability framework that is under development. An audit of the management control framework of both WD and the CFDCs for operational and loan funding will be undertaken concurrent with the evaluation.

Contribution assessment and approval

5.284 **Contribution agreements with CFDCs.** Following the transfer of the Community Futures program to WD in 1995 and a subsequent increase in its contribution limits, the Department entered new contribution agreements with CFDCs to more fully reflect its program objectives and reporting obligations.

5.285 We found that WD had signed new contribution agreements with all CFDCs in our sample. The agreements state the financial limits on both operating and investment funds for each CFDC. Contributions are identified as repayable, non-repayable, or conditionally repayable, depending on the terms and conditions of agreement. We found that amounts stated in the agreements and the funds subsequently provided were within the financial limits authorized by the Treasury Board.

5.286 However, it was not clear to us how WD established the amount of funding it would provide to individual CFDCs each year. Its contribution agreements require CFDCs to indicate any additional sources of funding. Many CFDCs are involved in a range of social and economic development activities, often in a fee-for-service arrangement with another government department. Management at WD told us that it takes these additional sources of income into account in its funding decisions. However, the documentation supporting the contribution agreements we audited gave no indication of how WD had established amounts of annual funding.

5.287 **Recommendation.** The Department should ensure that its decisions on how much funding CFDCs receive are properly supported and documented.

Department's response. The Department agrees. WD's decisions on funding for CFDCs are supported by an analysis conducted in 1998 of annual funding levels required by CFDCs to deliver core services. Many factors are considered to determine individual CFDC funding, such as anticipated interest revenue from investment funds, cost of serving remote communities and/or large geographic areas, economic hardship of communities served, and high numbers of targeted clients (Aboriginal, Francophone, persons with disabilities).

Each CFDC submits an annual operating plan providing in-depth information related to the funding request, including sources of funding and expenditures for all activities, as well as information on the previous year's performance.

WD will review the current annual processes and level of documentation to determine what further action may be required.

Financial and performance monitoring

5.288 **CFDC lending needs closer monitoring.** The program terms and conditions set out a number of clear expectations for the conduct of CFDCs. In particular, they give CFDCs the difficult task of lending to businesses that are viable but that cannot get financing elsewhere. Accordingly, WD considers CFDCs to be high-risk lenders. As a result, we expected that WD would actively monitor the operations and lending activities of each CFDC.

5.289 We found that WD has begun to implement an adequate system for monitoring the operations and lending activities of CFDCs. Until recently, however, its monitoring consisted primarily of reviewing CFDC business plans, annual reports, and audited financial statements. While these are useful sources of information, they do not cover many of the performance expectations set out in the program's terms and conditions . Monitoring progress toward those expectations requires a good knowledge of CFDC lending activities.

5.290 WD officials also have informal ways of checking on CFDCs. In our view these practices are insufficient. WD officials maintain telephone contacts with CFDC officers to stay informed of general developments and activities in the region. They also make ad hoc visits to CFDCs. However, these contacts do not provide a systematic and objective overview of CFDCs' lending activities to ensure that they are meeting the program's terms and conditions. Management in the Department told us its procedures reflect a desire to remain at "arm's length" from the lending decisions of CFDCs. We recognize that the program's terms and conditions clearly do not require WD to be involved in individual lending decisions by CFDCs. At the same time, they do require the Department to know whether CFDCs are complying with the contribution agreements.

5.291 Starting with the fiscal year ending 31 March 2001, WD asked each CFDC to have its auditors provide an opinion on its compliance with the contribution agreement along with the annual opinion on its financial statements. In our view, this should provide WD with good information on the overall lending activities of each CFDC. However, we found these opinions on compliance in only half of the files we examined. Management informs us that the financial statements for the year ending 31 March 2001 were due at the end of July. The Department is following up with CFDCs who submitted statements that did not meet its reporting standard.

5.292 Monitoring means more than simply getting information; it also means acting on it. From time to time, WD has carried out limited reviews of specific CFDCs and found weaknesses in their loan procedures, including a high proportion of loans that were in arrears. We found no indication that WD had acted on these problems. Although it informed us that it is addressing these deficiencies, we found no evidence that its monitoring or follow-up of the CFDCs in question has become more active. We also found that management was aware of non-compliance with the terms and conditions of the program in specific cases but had not acted to correct the problems.

5.293 **Recommendation.** The Department should ensure that it has accurate and timely information on the activities of CFDCs and should address problems appropriately as they arise.

Department's response. The Department agrees. WD implemented an effective monitoring system through a quality assurance review process that became effective July 1, 2001. The Department is committed to implementation of this system, including improved file documentation and taking appropriate action on issues identified as a result of the monitoring procedures.

5.294 **Financial management and control.** We found that WD exercised adequate control over disbursements to CFDCs for operating costs. As required by the contribution agreements, CFDCs provide quarterly and annual reports on their expenses and submit audited financial statements.

Conclusion

5.295 Western Economic Diversification Canada provides contribution funds to CFDCs on a five-year cycle. Any contribution program emphasizes the continuing responsibility of the funding organization to monitor and report on the use of the funds and the obligation of the recipient to meet certain conditions throughout the life of the contribution agreement. WD's monitoring of the performance of CFDCs relies heavily on information whose accuracy it does not systematically assess. Although it is making improvements, WD's monitoring procedures do not yet enable it to adequately assess whether CFDCs are complying with the program's terms and conditions. In our view, Parliament does not receive enough information on the results of the Community Futures program.

Section 9

Follow-Up: Department of Canadian Heritage—Grants and Contributions Under the Multiculturalism Program (1998, Chapter 27)

Background

5.296 In 1998, we audited the Multiculturalism program of the Department of Canadian Heritage. We reported that the results expected from the program's grants and contributions were not linked clearly with its objectives. In 30 percent of the cases we reviewed, we noted a lack of due diligence in assessing and approving projects for funding. We also found inadequate follow-up on the performance of projects. We recommended that the Department further clarify the objectives of the Multiculturalism program by defining clear, attainable goals and expected annual results; ensure that due diligence is exercised in reviewing and approving grants and contributions under the program; and ensure that recipients of funding provide the required information on their projects' performance.

5.297 A later internal audit of projects funded under the program between October 1998 and 31 March 1999 identified a continued lack of due diligence in a number of areas. A second internal audit of projects approved for funding between January and May 2000 found that 19 percent of the audited files did not meet the minimum standard of due diligence, and in another 37 percent it was only "borderline acceptable."

5.298 In our 2000 Report, Chapter 33, Follow-Up of Recommendations in Previous Reports, we noted that the Department had not made satisfactory progress on any of our 1998 recommendations.

Focus of the follow-up

5.299 In our follow-up this year, we looked for progress toward correcting these problems. We reviewed tools and processes that the Department had developed and put in place in response to our observations and recommendations. We also interviewed officials and examined a sample of files.

5.300 Our sample was selected at random from files on grant and contribution projects approved by the Department after 1 April 2001. We thought that if the Department had resolved the problems, these more recent files would be the most likely to demonstrate the improvement.

Conclusion

5.301 Our follow-up found that since our last report in December 2000, the Department of Canadian Heritage has made satisfactory progress in addressing our 1998 recommendations.

Observations

5.302 We are pleased to note that the Department of Canadian Heritage has finalized a performance framework for the Multiculturalism program. This framework sets out goals, expected results and performance indicators. We encourage management to use the framework fully in the future.

5.303 We noted as well that the Department has made major changes in the way it processes grants and contributions. Developing and using tools is a step in the right direction to improve the management of grants and contributions. But to ensure due diligence, it is important that the Department follow the established process and obtain the information it needs to assess the merits of proposed projects.

5.304 We found that the Department has made good progress in acting on the problems we reported in 1998. For example, each project file lists the program objectives, spells out the need that the project will meet, links the expected results to that need, and gives other sources of funding. Although it has not yet fully applied it, the Department is implementing a management framework that is proceeding as expected. The framework is an important part of ongoing changes in management and staff practices.

5.305 Among the tools the program officers use in assessing a project proposal is a complexity assessment that incorporates various potential risks. For one of these risks, the sensitivity of the project, the tool attempts to anticipate unexpected social or political outcomes. However, we note that these unwanted potential outcomes are not recorded in the files, making later management review difficult. We encourage management to continue using and refining this tool.

5.306 In 1998 and last year we expressed concern about final reports missing on completed projects. Management has informed us that it no longer requires final reports for projects funded through grants, although it does request them. Our original recommendation is therefore no longer relevant to grants since the program's rules have changed. Nevertheless, it is unclear how management will track the results of these projects in the future for program performance and accountability purposes. Contribution recipients are expected to provide a report at the end of their projects. It is too early to tell whether final reports are routinely received for projects funded through contributions.

Section 10

Follow-Up: Industry Portfolio, Investing in Innovation (1999, Chapter 19)

Background

5.307 Industry Canada, the National Research Council, and Natural Sciences and Engineering Research Council (NSERC) promote innovation in Canadian industry through various research and development programs. Our 1999 audit sought to determine whether four grant and contribution programs were designed well to help improve Canada's innovation performance. Our follow-up this year reviewed the actions taken in response to our 1999 recommendations.

Conclusion

5.308 Industry Canada, NSERC and the NRC have made reasonable progress in addressing all of our 1999 recommendations. While Technology Partnerships Canada has fully implemented one of our recommendations and has put in place some monitoring practices, it has not yet established a comprehensive portfolio monitoring system.

Observations

Industry Portfolio

5.309 The Industry Portfolio is a diverse collection of departments and agencies, all with responsibilities touching on at least one aspect of Canada's system for innovation. In developing policy and delivering programs, improving innovation is one objective but not the only one. In 1999 we reported that individual programs we audited were providing some information on how they contributed to innovation. However, we noted that the Industry Portfolio as a whole had not set out fully its co-ordinated strategy for linking the spending decisions of its member organizations to improving innovation or addressing innovation gaps in the economy. Management recognized an important opportunity for Industry Portfolio programs to work in concert. Program managers needed to agree on what innovation performance issues could best be addressed by the Portfolio and what results would be expected from each of its grant and contribution programs.

5.310 Industry Canada has developed an approach to innovation that focusses on four interrelated elements: knowledge infrastructure, commercialization of knowledge, human resources, and business environment. The organizations in the Portfolio are addressing each of these elements. Industry Canada has also set a number of targets for the results expected from the Portfolio's wide-ranging programs and activities. These expected results provide a reference framework for each organization in the portfolio to target the results of its own programs and initiatives.

5.311 The January 2001 Speech From the Throne laid out an agenda for the Government of Canada that had, as its first statement, a focus on "building a world-leading economy driven by innovation, ideas and talent." The federal government, under the leadership of Industry Canada, is currently drafting an innovation paper that will include both an analysis of Canada's current innovation performance and an indication of the future directions it intends to take to strengthen that performance. The paper is intended to stimulate a broad national debate on innovation issues.

National Research Council

5.312 **Industrial Research Assistance Program.** The National Research Council delivers the Industrial Research Assistance Program (IRAP), which helps small and medium-sized enterprises develop and exploit technologies.

5.313 In 1999 we found that in only 15 percent of the projects we audited had the program based its funding decisions on an assessment of all the project criteria. The need for program funding was not explained in 84 percent of the projects we audited. While the assessments of technical feasibility were reasonably complete and thorough, it was less clear to what extent projects would increase the technological competence or the innovation capability of the funding recipients. We also found little information on the success and results of funded projects. Therefore, we recommended that the program establish its expected results and report the actual results; ensure that it assessed the merit of projects and their need for program funds; gather information on results of individual projects; establish a results-based plan and performance measures for its advisory services; and conduct an evaluation of the program.

5.314 Since 1999, IRAP has redefined its design and become more client-focussed rather than project-focussed. As part of this redesign exercise, it restated its expected results and redefined its program processes, emphasizing more complete assessment of the merits of projects and their need for IRAP funding. It also began using tools to manage and monitor key aspects of its client relationships.

5.315 The program also conducted studies to determine its impact on client companies. It used that information to develop a performance framework that applies to IRAP's advisory services as well as the activities it funds.

5.316 IRAP has designed and developed processes and automated tools to assist in the collection and compilation of information on results. The automated system, in place since April 2001, helps to structure the collection and reporting of the information.

5.317 IRAP's performance report provides general information on the program's performance and includes selected information on the results achieved by specific program initiatives. IRAP indicates that its new automated process for collecting and compiling client information will allow for more complete aggregated reporting on the program's contribution to Canada's innovation.

5.318 The National Research Council indicated that it will begin a comprehensive evaluation of IRAP in late 2001. The evaluation design includes questions on the program's success in achieving expected results.

5.319 IRAP'S comprehensive approach to re-examining its contribution to Canadian innovation seems to include all the items we identified in 1999.

Because it has taken a comprehensive approach, its action on our recommendations is taking longer than it might have otherwise. IRAP should continue to focus on changing its processes to ensure that it can demonstrate its contribution to Canada's innovation and report that contribution fully to Parliament.

Natural Sciences and Engineering Research Council

5.320 **Research Partnerships Programs.** The Research Partnerships Programs foster interaction and partnership between university researchers and researchers in other sectors. The purpose is to generate new knowledge, develop new expertise, and transfer this new knowledge and expertise to Canadian-based organizations.

5.321 Our recommendations to NSERC in 1999 focussed on its need to clarify the results expected of the Research Partnerships Programs (RPP) and to report progress toward achieving them; to ensure that project assessments examine the nature and significance of project benefits and the need for NSERC funding; to gather information on the results of projects; and to conduct an evaluation of the Research Partnerships Programs.

5.322 NSERC has clarified the expected results of the Research Partnerships Programs and has developed performance indicators for the programs. NSERC has rewritten guidance for applicants on the results expected of its programs. File documentation indicates that NSERC is examining applications to ensure that expected results are clearly stated, including the nature and significance of the project's expected benefits. Further, NSERC conducted an environmental scan that will assist in further refining its programs.

5.323 In March 2001, the Treasury Board approved new terms and conditions for NSERC. In particular, the Treasury Board provided NSERC with direction on how to deal with applicants' needs for funding. Applicants are required to provide enough information for a review committee to assess other sources of funding and recommend the appropriate level of funding by NSERC.

5.324 NSERC conducted a pilot project to obtain information on the longer-term impacts of projects (that is, after two years) under one element of the RPP, the Collaborative Research and Development program. It plans to expand this initiative to other elements of RPP and to some of its other programs. It also evaluated two components of the Research Partnerships Programs, addressing important questions about the success and performance of the components. These are all useful activities that provide information on overall performance and help gather information on project results.

Industry Canada

5.325 **Technology Partnerships Canada.** Established in 1996, Technology Partnerships Canada was a relatively new program at the time of our audit. The program promotes the development and commercialization of innovative technologies that help increase economic growth and create jobs and wealth. We found that during the first years, management established practices for due diligence in assessing project proposals. Our 1999 report recommended that TPC ensure that it appropriately justified the amounts it contributed, monitor funded projects, and improve specific aspects of reporting to Parliament.

5.326 In its 1999 response to our recommendation to justify amounts contributed to specific projects, TPC indicated that it based its funding decisions on information that varied from project to project and, on occasion, it would continue to use alternative evaluation strategies to support project assessment. TPC continues to maintain flexibility in negotiating the amounts of certain transactions. It documents those investment decisions as part of the assessment process.

5.327 In response to our recommendation on project monitoring, TPC committed to fully implement a comprehensive portfolio monitoring system before 31 March 2000. However, additional work is still needed to complete this monitoring system.

5.328 Nevertheless, since 1999, TPC has taken steps on many fronts to improve its monitoring of projects. Our follow-up found that it is more systematic in monitoring repayments, benefits, and compliance with contribution agreements for individual projects. It has developed a formal *Program Assessment Guideline for Due Diligence*, and project files indicate that the guideline is being applied. TPC has entered into an agreement with Industry Canada's Co-ordination and Management Services to monitor its contribution agreements during the repayment phase. It has established a contribution audit plan to verify the compliance of specific projects, based on defined risk-related criteria.

5.329 Finally, TPC's annual report to Parliament now explains more completely its leveraged funds, the sharing of risk and return, the main factors it uses to determine risk and return, and the extent to which contributions are fully repayable.

Follow-Up: Human Resources Development Canada—Grants and Contributions (2000, Chapter 11)

Background

5.330 In 1999–2000, Human Resources Development Canada (HRDC) spent about $3 billion on non-statutory or voted grant and contribution programs and those under Part II of the *Employment Insurance* Act. In 1999, its Internal Audit Bureau audited project files that represented about $234 million in grants and contributions. The internal audit revealed serious and widespread problems in the Department's systems and practices for managing grants and contributions. In particular, it found inadequate processes for selecting and approving projects, inadequate monitoring of projects, and unacceptable financial management practices. The Department accepted the findings of the internal audit.

5.331 In 2000, we examined four of the grant and contribution programs the 1999 internal audit covered. Our work extended to areas the internal audit had not reviewed, such as program design, management of individual projects, and the measurement of project and program results. We also assessed corrective action HRDC had taken in response to its internal audit findings, including the progress it had made and had reported.

5.332 We concluded in 2000 that there were widespread deficiencies in the management control frameworks of all four programs. We reported that our observations confirmed and extended those of the Department's 1999 internal audit. We also indicated that corrective actions and plans HRDC was implementing would address the deficiencies our audit had found. In particular, we reported that HRDC had made good progress toward meeting the commitments in its Six-Point Action Plan, and work was proceeding on related initiatives aimed at expanding or complementing the action plan. The Department responded positively to our recommendations and agreed to sustain its progress in meeting the commitments of the action plan and related initiatives.

Focus of the follow-up

5.333 In this follow-up, we reviewed HRDC's progress in responding to our October 2000 recommendations and the recommendations made by the Standing Committee on Human Resources Development and the Status of Persons with Disabilities. However, we did not review the Department's progress in responding to the recommendations made by the Public Accounts Committee on 17 May 2001; most of those recommendations concerned performance reporting for 2001–02, and the Department's performance report had not been released at the time of our audit.

5.334 We examined various documents, including the Department's progress reports on its Six-Point Action Plan and other initiatives. We assessed the reliability of an internal audit of the National Grants and Contributions Performance Tracking Directorate. We also interviewed staff and managers responsible for administering and managing grant and contribution programs, and we visited two regional offices and two human resources centres. This follow-up provides audit-level assurance, unless otherwise indicated.

Conclusion

5.335 We found that Human Resources Development Canada has made good progress in acting on our recommendations and on those of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities. We encourage the Department to maintain its momentum in fully implementing recommendations. In particular, HRDC set up a system for tracking the performance of several grant and contribution programs, developed guidelines and tools, trained program delivery staff and managers, and reported its progress to the public and Parliament. The new integrated information system it is developing is on schedule and should be ready by December 2002. HRDC recently started developing comprehensive risk management frameworks to manage contribution projects more efficiently and effectively. It is also streamlining its practices and tools to reflect risk management principles. We encourage the Department to sustain those efforts.

5.336 We found that the Department has developed results-based accountability frameworks and improved equality of access to all 26 of its voted grant and contribution programs as well as those under Part II of the *Employment Insurance Act*. It strengthened its internal audit function and established a follow-up process to monitor the progress of corrective action on internal audit findings.

5.337 As part of the Six-Point Action Plan, the Department committed to review files of projects that were likely to have received overpayments and that were active in 1998–99 and 1999–2000 but have ended since then (dormant files). The Department completed its review of a sample of dormant files from both years to identify overpayments attributable to sponsors' actions. We cannot conclude that the reviewed files are representative of all high-risk dormant files because of weaknesses in how files were selected. We recommend that the Department consider reviewing additional dormant files for these two years.

5.338 Ongoing tracking of performance is essential to assessing whether the balance between controls and services is appropriate. The Performance Tracking Directorate has confirmed that in the programs where performance is monitored, financial controls have been strengthened. These programs represent about 63 percent of the total value of all voted grant and contribution programs, as well as those under Part II of the *Employment Insurance Act*, that are delivered by the Department. At the end of our follow-up, management was completing a review of Aboriginal programs that should further extend the coverage of the Directorate. We did not examine that review. HRDC is developing plans to monitor the performance of the remaining programs. Whether it has reached the right balance between controls and services is difficult to say at present, because service performance information is currently being developed.

Observations

Quality assurance measures

5.339 Significant improvements in administering several grant and contribution programs. In our 2000 Report, we recommended that the Department put in place quality control measures to review corrective action, and ongoing monitoring to ensure that staff understand the fundamentals of financial control. To support the Six-Point Action Plan, Human Resources Development Canada developed a quality assurance framework. It had begun to implement it at the time of our audit last year and this will continue for some time.

5.340 Overall, the Department is making good progress with quality assurance measures that provide for ongoing monitoring and ensuring that staff understand the basics of financial control. New quality assurance measures include quality control at the local level, post-audit and compliance functions at the regional level, and the Performance Tracking Directorate at the national level.

5.341 Local measures. Program operations consultants provide technical expertise, monitor 15 percent of files to ensure program integrity, and report regularly to management on the findings of file reviews. They also provide feedback, coaching, and training to project officers. Most of these new positions were staffed only recently and training is still under way or has just finished. It is too early to assess the effectiveness of this new quality control function.

5.342 Regional measures. Post-audit financial review ensures compliance with HRDC policy, the Treasury Board's transfer payments policy, and relevant sections of the *Financial Administration Act*. Regional program compliance officers confirm that procedures and guidelines are being followed and that projects conform to program terms and conditions. The objective is to review a sample of 5 percent of projects managed by responsibility centres. A risk assessment identifies the responsibility centres subject to post-audit and compliance review. We noted on our field visits that review methodologies were in place and a first cycle of reviews had begun. Again, it is too early to assess the effectiveness of these new control mechanisms.

5.343 National measures. The National Grant and Contribution Performance Tracking Directorate provides for quality control in measuring performance and improvement in the overall administration of grant and contribution programs. It has the following mandate:

- assess the overall program integrity of grant and contribution activities in HRDC by performing file reviews and financial verifications;
- highlight key areas of risk and provide guidance on approaches to mitigate those risks;
- contribute to knowledge transfer throughout the Department; and
- co-ordinate activities with other monitoring and post-audit functions in HRDC and by outside agencies to ensure adequate coverage without duplication.

5.344 The Department's Internal Audit and Risk Management Services audited the work of the Performance Tracking Directorate. The audit focussed on the Directorate's activities related to the first three quarterly progress reports. These reports account for the reviews of projects that started between 1 February and 30 June 2000. The internal audit concluded, among other things, that project files were selected properly and the review methodology was applied consistently. We found these two conclusions reliable, based on our review of the internal audit work.

5.345 The reviews by the Performance Tracking Directorate show that after the 1999 internal audit there were significant improvements in administering several grant and contribution programs during the period reviewed. The Directorate's reviews outlined in Exhibit 5.5 touched on some major deficiencies that we also identified in our 2000 audit. Review reports also identify areas for improvements. We encourage the Department to set benchmarks for determining what constitutes appropriate performance and systematically identifying areas that need improvement.

5.346 Given that the Directorate's mandate is to assess the overall integrity of grant and contribution programs, we would have expected the reviews to provide assurance that all voted grant and contribution programs delivered by HRDC are well managed. In fact, the Directorate's reviews covered about 63 percent of HRDC's voted grant and contribution programs as well as those under Part II of the *Employment Insurance Act* (Exhibit 5.6). The Directorate is taking steps to conduct special reviews of the programs that have not been covered. It was completing a special review of Aboriginal Human Resources Development agreements in the Aboriginal Relations Office as we were writing this report which should further extend the coverage of the Directorate. We did not review it. It also plans to conduct special reviews of the remaining programs. Management informed us that programs involving transfer payments to provinces and/or territories are excluded from the Directorate's reviews because external or legislative auditors audit these expenditures.

5.347 We found that the Directorate's performance reports do not clearly indicate the dollar value and number of projects in each grant and contribution program that its reviews included and excluded. The review results reported in Exhibit 5.5 apply only to the grant and contribution programs it examined.

5.348 The Performance Tracking Directorate is responsible for reviewing the management of all stages in the project life cycle, including the closeout stage. Management informed us that the Directorate has not yet reviewed a statistically valid sample of files closed in 2000 because only few of the projects it selected for review had reached the closeout stage. It plans to conduct a special review of closed files.

5.349 The Directorate also uses ongoing review of its quality control framework and reporting processes to identify areas for improvement. Co-ordination of its activities with those of other monitoring and post-audit functions is expected to evolve as those other functions develop. This will help to avoid duplication and share best practices.

5.350 **Recommendation.** The Department should ensure that in its regular performance reports, the Performance Tracking Directorate clearly indicates the scope of its reviews by specifying for each grant and contribution program the dollar value and number of project files that its reviews covered and did not cover. It should ensure that the Directorate extends its review to the programs not yet examined, in order to provide assurance that the Department is managing adequately all voted grant and contribution programs, as well as those under Part II of the *Employment Insurance Act*, that it delivers.

Department's response. The Auditor General recognized in his October 2000 Report and in subsequent appearances before the Public Accounts Committee the steps the Department had taken to strengthen the administration of its grant and contribution programs. HRDC is pleased that the Auditor General continues to recognize the good progress the Department is making to strengthen the management of these programs.

The Auditor General previously described the Performance Tracking Directorate (PTD) established by HRDC as "an innovative system of tracking performance – one that allows for tracking improvements in the management and administration of grants and contributions" that will "give management an ongoing measure of performance in the management and control of grants and contributions."

HRDC agrees with the specific recommendation in this chapter to improve this management tool. The Department has in fact already taken action in this regard. Consistent with the established methodology and mandate for the PTD, HRDC senior management, in August 2001, expanded its coverage to include grant and contribution programs excluded from the initial reports. In addition, the PTD reports will include information on the dollar value of the project files included and excluded from the review of each program, as recommended by the Auditor General.

Recent audits and reviews detected few overpayments

5.351 **Problem files.** In 2000, we recommended that the Department use quality control measures and ongoing monitoring to ensure that all overpayments in problem files are properly identified and recovered.

5.352 We indicated in the Auditor General's 2000 Report (Chapter 11, Human Resources Development Canada—Grants and Contributions, paragraph 11.79) that overpayments could be established only when the Department could show that the project sponsor did not fulfil the obligations stipulated in the contribution agreement. These overpayments are then recorded as account receivables for recovery purposes. When performing financial reviews of project files, the Performance Tracking Directorate identifies and reports on the nature and extent of incorrect payments attributable to inappropriate practices by the Department and by the sponsor. Examples of inappropriate practices by the Department include making payments for ineligible expenses or outside the funding period. In the four programs we examined in 2000, we found that incorrect payments due to inappropriate practices by the Department were significant. Results of reviews by the Directorate (Exhibit 5.5) show significant improvements in reducing inappropriate practices. It is important that the Department continue to gather comprehensive information on incorrect payments due to inappropriate practices to identify their significance, their causes and appropriate corrective actions. This information is necessary for assessing the effectiveness of the grant and contribution payment process.

5.353 That said, we found that in identifying problem file overpayments attributable to sponsors, the Department has made good progress. In 2000,

Exhibit 5.5 Trend in the results of reviews by the Performance Tracking Directorate

Application					
Application for funding from sponsor on file	100	99.1	100	100	85.2
Assessment					
The written assessment demonstrates that the approved activity supports program objectives	94.2	87.2	77.6	87.3	31.8
Recommendation and approval					
Approval signed with correct delegation of authority	97.9	98.6	96.5	98	79.2
Contracting					
Nature of authorized expenses is clear	96.5	88.5	89.3	95	83.7
Signed in all required place by HRDC official with correct delegation of authority	100	99	100	100	86.6
Payment					
Advance amounts are within Treasury Board limits	N/A	97.2	93.8	98.1	71.3
Monitoring					
Project activities were monitored for compliance with Agreement	95.1	97.1	97.8	100	23.4
Compliance with terms and conditions					
Project activities meet program terms and conditions	97.9	94.1	84.2	92.2	N/A
Criteria with a compliance rate higher than 90 percent	91.7	81.5	80.4	79.4	N/A
Criteria with a compliance rate higher than 95 percent	83.3	70.4	66.7	69.8	N/A

[1] The results of the Directorate's review do not apply for the months of July and August 2000 as no projects were selected for review.
[2] Not audited.

Source: Human Resources Development Canada

we questioned the appropriateness of some payments in 81 of the 309 contribution agreements we examined. We asked the Department to review and correct these 81 problem files. We found in our follow-up that the Department had completed its review and had identified the overpayments attributable to sponsors. Exhibit 5.7 shows the overpayments that were identified in that review as well as those in other reviews and audits since 1999. They amounted to less than 0.3 percent of the total value of the projects examined in the four reviews indicated in the exhibit.

5.354 **Dormant files.** We had also recommended that the Department identify and recover all overpayments from high-risk dormant files, that is, files that were likely to contain overpayments and that were active in 1998–99 and 1999–2000 but later closed.

5.355 As part of the Six-Point Action Plan, the Department committed to review high-risk dormant files, and it selected 516 for review. Management informed us that the review of the 516 high-risk files required considerable effort. In this follow-up we examined how, in selecting these files, the

Exhibit 5.6 Review of grant and contribution programs by the Performance Tracking Directorate, 2000

[illegible]	[illegible]	[illegible]
Programs reviewed by the Directorate		
Labour market programs	839	41.4
Labour	2	0.1
Children and youth	210	10.4
Communities	137	6.8
Learning and literacy	48	2.4
Persons with disabilities	30	1.5
Total	**1,266**	**62.6**
Programs not reviewed by the Directorate		
Aboriginal people	322	15.9
Labour market programs, skills development	349	17.2
Children and youth	91	4.3
Total	**762**	**37.4**
[illegible]		
Transfer payments to provinces and territories:		
Labour market development agreements	891	–
Employability Assistance for People with Disabilities	192	–
[illegible]		

Source: Human Resources Development Canada (not audited) inappropriate practices by the Department were significant. Results of reviews by the Directorate (Exhibit 5.5) show significant improvements in reducing inappropriate practices. It is important that the Department continue to gather comprehensive information on incorrect payments due to inappropriate practices to identify their significance, their causes and appropriate corrective actions. This information is necessary for assessing the effectiveness of the grant and contribution payment process.

5.353 That said, we found that in identifying problem file overpayments attributable to sponsors, the Department has made good progress. In 2000,

Exhibit 5.5 **Trend in the results of reviews by the Performance Tracking Directorate**

Criteria	Directorate's review of projects (compliance rate in percentage)				Internal audit
	1 February to 31 March 2000 (142 files)	1 February to 30 April 2000 (219 files)	1 February to 30 June 2000 (58 files)	1 September to 31 December 2000 (102 files)[2]	1999 (459 files)
Application					
Application for funding from sponsor on file	100	99.1	100	100	85.2
Assessment					
The written assessment demonstrates that the approved activity supports program objectives	94.2	87.2	77.6	87.3	31.8
Recommendation and approval					
Approval signed with correct delegation of authority	97.9	98.6	96.5	98	79.2
Contracting					
Nature of authorized expenses is clear	96.5	88.5	89.3	95	83.7
Signed in all required place by HRDC official with correct delegation of authority	100	99	100	100	86.6
Payment					
Advance amounts are within Treasury Board limits	N/A	97.2	93.8	98.1	71.3
Monitoring					
Project activities were monitored for compliance with Agreement	95.1	97.1	97.5	100	23.4
Compliance with terms and conditions					
Project activities meet program terms and conditions	97.9	94.1	84.2	92.2	N/A
Criteria with a compliance rate higher than 90 percent	91.7	81.5	80.4	79.4	N/A
Criteria with a compliance rate higher than 95 percent	83.3	70.4	66.7	69.8	N/A

[1] The results of the Directorate reviews do not apply for the months of July and August 2000 as no projects were selected for review.

[2] Not audited.

Source: Human Resources Development Canada

we questioned the appropriateness of some payments in 81 of the 459 contribution agreements we examined. We asked the Department to review and correct these 81 problem files. We found in our follow-up that the Department had completed its review and had identified the overpayments attributable to sponsors. Exhibit 5.7 shows the overpayments that were identified in that review as well as those in other reviews and audits since 1999. They amounted to less than 0.3 percent of the total value of the projects examined in the four reviews indicated in the exhibit.

5.354 **Dormant files.** We had also recommended that the Department identify and recover all overpayments from high-risk dormant files, that is, files that were likely to contain overpayments and that were active in 1998–99 and 1999–2000 but later closed.

5.355 As part of the Six-Point Action Plan, the Department committed to review high-risk dormant files, and it selected 516 for review. Management informed us that the review of the 516 high-risk files required considerable effort. In this follow-up we examined how, in selecting these files, the

Exhibit 5.6 Review of grant and contribution programs by the Performance Tracking Directorate, 2000

Grant and contribution programs	Amounts ($ millions)	Percentage
Programs delivered by Human Resources Development Canada	**2,028**	
Programs reviewed by the Directorate		
Labour market programs	839	41.4
Labour	2	0.1
Children and youth	210	10.4
Communities	137	6.8
Learning and literacy	48	2.4
Persons with disabilities	30	1.5
Total	1,266	62.6
Programs not reviewed by the Directorate		
Aboriginal people	372	18.3
Labour market programs, skills development	349	17.2
Children and youth	41	2.0
Total	762	37.4
Programs delivered by provinces and territories	**1,083**	–
Transfer payments to provinces and territories:		
Labour market development agreements	891	
Employability Assistance for People with Disabilities	192	
Grand Total	**3,111**	–

[illegible]

Department ensured that the sample was representative of all high-risk dormant files. We would expect it to do the following:

- assign to programs a low or high risk of overpayments attributable to sponsors using a well-defined risk assessment model, focus the review on high-risk programs, and identify all high-risk projects using sound criteria applied consistently to all projects of the same program; and
- using a well-defined sampling methodology, select a representative sample from the population of high-risk dormant files to assess the significance of overpayments and determine the need for additional review of dormant files.

5.356 We found weaknesses in the process the Department used to identify high-risk files and select a sample. We expected HRDC to focus the review of dormant files on programs with a high risk of overpayments. We found that it did not establish the risk profile of each grant and contribution program. The risk assessment model the Department developed for the review of dormant files uses nine attributes to identify high-risk files. We found that the Department used only two of the nine attributes: dollar value greater than $100,000, and characteristics of the sponsor (that is, number of projects or contracts and the adequacy of the sponsor's management control framework). Management informed us that its methodology had relied on judgment in attempting to select the highest-risk files. We noted also that the Department did not apply consistently among programs the two attributes it did use. Nor did it properly document and support the rationale for its selection of files to review. Because of these weaknesses in the way the files were selected, we cannot conclude that the files selected for review are representative of the population of high-risk dormant files or are the highest-risk files.

5.357 The Department completed the review of dormant files in January 2001. It identified 35 overpayments attributable to sponsors that totalled about $430,000. We found that 83 percent of that amount represented

Exhibit 5.7 Overpayments identified by Human Resources Development Canada, 31 July 2001

	1999 internal audit	2000 review	2001 review	Office of the Auditor General 2000 Audit
	Projects before June 1999	Active files, February to 30 April 2000	Dormant files of projects completed in 1998–99 and 1999–2000	Projects completed before 31 December 1999
Number of projects	461	17,000	516	309
Value of projects	$234,000,000	$1,347,000,000	$211,000,000	$141,700,000
Amount of overpayments*	$230,649	$3,229	$430,457	$378,517
Percentage of overpayments	0.1%	0.0002%	0.2%	0.3%

*The overpayments identified include only those the Department considered attributable to the actions of a sponsor.

Source: Human Resources Development Canada

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- assign to programs a low or high risk of overpayments attributable to sponsors using a well-defined risk assessment model, focus the review on high-risk programs, and identify all high-risk projects using sound criteria applied consistently to all projects of the same program; and
- using a well-defined sampling methodology, select a representative sample from the population of high-risk dormant files to assess the significance of overpayments and determine the need for additional review of dormant files.

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Exhibit 5.7 Overpayments identified by Human Resources Development Canada, 31 July 2001

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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Percentage of overpayments	0.1%	0.0002%	0.2%	0.3%

*The overpayments identified include only those the Department considered attributable to the actions of a sponsor.

Source: Human Resources Development Canada

overpayments in only one program: Labour Market Partnerships. This suggests that the program had a high risk of overpayments. The objective of the program is "to work with partners to help communities, employers, and workers improve their capacity to address human resource requirements and to implement labour force adjustments." It is similar in design to the Sectoral Partnership Initiative that we audited last year and in which we found serious deficiencies. Given that a high percentage of the overpayments detected were from the Labour Market Partnerships program, we think the Department should consider reviewing additional high-risk files from that program.

5.358 At the same time, because the results of its review are not representative of all high-risk files, the Department needs to develop a risk profile for its other programs as a basis for deciding whether a review of additional dormant files is necessary.

5.359 **Recommendation.** The Department should consider reviewing additional high-risk files that were active in 1998–99 and 1999–2000 but later closed.

Department's response. The Department agrees with this recommendation and has already begun the process of reviewing its methodology for identifying additional high-risk files that were active in 1998–99 and 1999–2000 but later closed. This review will assist the Department in assessing the cost effectiveness of reviewing additional files.

Strengthening key controls

5.360 **Good progress in meeting the major commitments of the Six-Point Action Plan.** The core purposes of the Six-Point Action Plan the Department released in February 2000 were to strengthen the administration of grants and contributions and to correct the problems identified in the 1999 internal audit of grant and contribution programs. In 2000, we recommended that the Department strengthen key controls as it had committed to do in the action plan.

5.361 The Department has reported its achievements under the action plan in four progress reports; the latest was issued in April 2001. The results of two third-party assessment reports on the implementation of the action plan were also made public. The most recent third-party assessment, at 15 January 2001, revealed that HRDC had fulfilled, or would fulfil on schedule, all of its commitments. In our view, at 31 August 2001 the Department had made good progress toward meeting the major commitments of the action plan. It continues to dedicate the necessary effort and resources. We found that the Department has generally met the target dates for completing its planned activities.

5.362 The Department continues to track performance through regular monitoring by the Performance Tracking Directorate. Management is also making good progress in important long-term and supporting activities such as enhancing tools, delivering training, developing a new integrated information system, and reporting progress to the public and Parliament.

5.363 **The Department strengthened its internal audit function.** In 2000, we recommended that key controls be supported by a strong internal audit function that meets the highest professional standards. We also recommended that the Department put in place a well-established system for taking corrective action on internal audit findings and following up on that action.

5.364 We found that the Department has made good progress in strengthening its internal audit function, Internal Audit and Risk Management Services (IARMS). In 2000–01, the number of staff in the internal audit function increased from 33 to about 50. IARMS is developing a departmental internal audit policy and a follow-up audit policy. In addition, it recently developed a draft audit manual outlining audit policies, standards, and procedures as well as a quality assurance review process to ensure that all internal audits meet professional standards.

5.365 The Audit and Evaluation Committee, chaired by the Associate Deputy Minister, is responsible for tracking management responses to audit recommendations to ensure that the Department takes timely and effective corrective action. In May 2001 the Committee approved the process for following up on corrective action. At the end of September 2001, the Audit and Evaluation Committee had not received any follow-up report on corrective action. We were told that a follow-up report would be forwarded to the Committee soon.

Program management study

5.366 **Study of grant and contribution programs.** In 2000, we noted that the Department needed to state the expected results of programs in clear and measurable terms and use project results and program evaluations to make necessary changes and modifications (manage for results). We recommended that the Department complete the program management study it had initiated to ensure that the desired results of all grant and contribution programs were clearly defined and that performance measures were in place to demonstrate the achievement of desired results. We also recommended that the Department ensure, in consultation with the Treasury Board Secretariat, that it would meet its proposed timeframe for reviewing the objectives of all its grant and contribution programs and making appropriate changes, including measurement of results. The Treasury Board's new transfer payments policy, effective June 2000, requires that all new and renewed grant and contribution programs have results-based accountability frameworks in place.

5.367 Our follow-up found that the Department has made good progress. In May 2000, HRDC had initiated a comprehensive program management study with two objectives: to ensure that all programs have clear objectives and results-based accountability frameworks in place; and to renew the terms and conditions of these programs by the end of 2002. The study concluded that 12 of the 26 active voted grant and contribution programs and those under Part II of the *Employment Insurance Act* already had adequate results-based accountability frameworks in formal partnership agreements with the provinces and Aboriginal communities. Results-based accountability frameworks were developed for the remaining 14 programs. As at the end of our follow-up, the Department was awaiting the Treasury Board's final comments on the frameworks.

5.368 The Department recognizes that results-based management is a long-term process and it takes time to develop indicators and align management systems, even before collecting performance data. Some programs have identified performance indicators for which data are not yet available. We noted that some frameworks rely heavily on evaluation cycles to indicate results. At present there is only one indicator of service quality, speed of service, for only some benefit transactions under the employment program. At the end of our follow-up, the Department was assessing the quality, availability, and cost effectiveness of indicators for all its grant and contribution programs with a view to identifying a final set of indicators. We encourage the Department to complete this work for all programs as soon as possible.

5.369 The Treasury Board's revised transfer payment policy requires departments to review and resubmit for approval the terms and conditions of all grant and contribution programs by 31 March 2005. HRDC has chosen to meet this requirement by the end of 2002. It has begun reviewing the effectiveness and relevance of all its grant and contribution programs to ensure that they address the government's priorities. It has also identified priorities for renewal of program terms and conditions and has begun to review them.

Equality of access

5.370 **Improved equality of access to the Department's grant and contribution programs.** In 2000, we noted that the methods used to promote grant and contribution programs did not always ensure that all potential applicants had equal access to the program. We recommended that the Department assess whether the information it provides to Canadians on grant and contribution programs adequately promotes equality of access and that it take corrective action as required.

5.371 We have found that the Department has made progress in improving equality of access to all grant and contribution programs. Since December 2000, its public Web site has provided detailed information on objectives, eligibility criteria, and applying for all its voted grant and contribution programs as well as those under Part II of the *Employment Insurance Act*. Information kits and information pamphlets for sponsors are available through local offices and these also contribute to equality of access to programs. The Department also examined equality of access as part of the program management study. The study found that some programs have adopted measures such as on-line application, guidelines for applicants, regional consultations, and national and local advertisements to ensure and promote equality of access.

Equip and support staff

5.372 **Continued support for change.** We recommended in 2000 that management sustain its current strong support for change to ensure that staff are fully equipped and supported. We also recommended that the Department conduct ongoing monitoring of the impacts of new tools, training, concepts, and approaches.

5.373 In our follow-up, we found that senior management has continued to provide staff with the necessary ongoing support for change. First, we noted in our review of some performance agreements that departmental executives and managers responsible for grants and contributions are explicitly accountable for implementing the Six-Point Action Plan. The Treasury Board approved a reallocation of $50 million from existing budgets in 2000–01 for implementing the action plan and other related initiatives. We believe that this reallocation has helped the Department provide the necessary tools, training, and systems support for making the required changes. In addition, regular reporting of progress to staff and the public has helped maintain momentum.

5.374 We found that the Department has made good progress in several initiatives to equip and support staff in their work. In particular, it developed operational policies and model files, adopted a new grant and contribution manual, and improved the departmental information systems. The Department developed and provided mandatory training courses to managers and staff. Management informed us that by the end of March 2001, about 1,600 program delivery staff from all provinces and territories had attended mandatory training in program delivery. The Department also indicated that managers attended relevant courses on various topics such as modern comptrollership. It is currently developing a course on program integrity and public accountability.

5.375 The Department has monitored some of the impacts of the new tools and training. For instance, the Performance Tracking Directorate found that new tools and training and other initiatives outlined in the Six-Point Action Plan had significantly contributed to the strengthening of financial controls. However, the impacts on the quality of services and the efficiency and effectiveness of grant and contribution activities have not been assessed formally.

5.376 **New integrated information system is expected to be completed by December 2002.** Under the Six-Point Action Plan, the Department committed to develop better information systems over the next three years that would simplify the management and monitoring of projects. We recommended that the new information system be fully integrated with the Department's financial system. In 2000 we reported deficiencies in the capacity of current information systems to provide timely and useful performance information, such as information on sponsors' current and past projects with the Department. Our follow-up found that the Department has upgraded its current systems to make financial information on grants and contributions available from one system. However, this interim measure does not meet all the information needs of project officers and managers. On visits to regional and local offices we found that client, contract, and performance information on individual projects is difficult to obtain; it must be retrieved—when the information is available electronically—from various systems that are not integrated.

5.377 An integrated information system is critical to ensuring sound and effective administration and monitoring of grant and contribution programs. We found that the Department has made progress in developing a new integrated information system, the Common System for Grants and Contributions. Since May 2001, the Department's Intranet site has provided project officers and managers with access to electronic tools such as sample model files, project checklists, and on-line training. The integration of client information with the financial systems and the monitoring of the client's progress through each intervention of the Common System are expected to be completed by March 2002. The Department expects that by December 2002 at the latest, it will have completed the remaining components of the Common System, such as the administration of all business elements of contracts and the design and development of various performance reports. We encourage the Department to take all the necessary steps to meet that target completion date.

Comprehensive analysis of workload

5.378 **Workload analysis identified the need for supplementary funding.** In 2000, we recommended that the Department, in collaboration with the Treasury Board Secretariat, complete a workload analysis of the resources needed to deliver different types of grant and contribution programs. HRDC committed to conduct a study of its operational capacity by December 2000. Its purpose was to determine the incremental resources needed to implement the Six-Point Action Plan.

5.379 The Department completed its capacity study in May 2001. The study concluded that to manage $1.6 billion of grant and contribution program funds under the new guidelines would require incremental funds of roughly $75 million. The Department developed various costing methodologies to estimate that amount because it did not have activity-based costing systems and a streamlined financial coding structure for all its grant and contribution programs. We have not assessed the reasonableness of the estimate.

5.380 The Treasury Board authorized $50 million in 1999–2000; it did not approve funding for future years. However, it asked HRDC to provide a justification for permanent funding levels, taking into account the results of two studies: a third-party study of possible delivery models for the Department's grant and contribution programs; and the Department's program management study. The third-party study team was asked to assess whether a more optimal delivery model was feasible, given that in the workload analysis HRDC had identified the need for more funds to improve the administration of its grant and contribution programs and implement the Six-Point Action Plan.

5.381 The third-party study, completed in July 2001, concluded that the Department's current delivery model needed significant changes to increase the efficiency of operations, the quality of service, and the consistency of controls, as well as reducing administrative complexity. The report recommended the automation of the grant and contribution delivery process; the concentration of administrative processes at one or several delivery points; and the specialization of specific steps in the processes. It added that it could not compare costs with those of other government departments because costing information was not available in enough detail.

5.382 The Department has also considered several initiatives to streamline the current delivery model and thereby reduce costs. It is currently evaluating the savings that could result from these initiatives, which include implementing risk management frameworks. At the end of our follow-up, the Department was integrating the results of the review of delivery models, the capacity study, and the program management study. The integrated results would serve as a basis for determining the amount of permanent funding it would request from the Treasury Board.

Balancing control and service

5.383 **Commitment to achieve the right balance between controls and services.** In 2000, the Standing Committee on Human Resources Development and the Status of Persons with Disabilities asked the Department to report by 1 June 2001 on how it had struck a balance between decentralization, flexibility, and control. In its June 2001 response to the Committee, the Department reported that striking the right balance between responsive and flexible service to Canadians and sound financial controls is difficult to achieve and requires constant effort to maintain. It also noted the need to stay in touch with its stakeholders and carefully apply risk management principles to maintain the right balance.

5.384 We have found that the Department remains committed to achieving the right balance between controls and services. Ongoing tracking of performance is essential to assess whether the balance is achieved and to determine areas that need corrective action. The Department's performance tracking system has confirmed that in the programs where performance is monitored, financial controls have been strengthened. These programs represent about 63 percent of the total value of all voted grant and contribution programs, as well as those under Part II of the *Employment Insurance Act*, that are delivered by the Department. HRDC is developing plans to monitor the performance of the remaining programs.

5.385 On our visits to regional and local offices, we found that managers and project officers have very little performance information on services in most grant and contribution programs. Our review of the program management study revealed that the majority of the 26 grant and contribution programs have no service-related performance indicators and standards. The quality of service is monitored informally; no formal assessments are carried out. The Department is developing client service indicators as part of its program management initiative. Given the current lack of service performance information, it is difficult to conclude whether the Department has reached the right balance between controls and services. Management informed us that by June 2002 it would complete the final policy and framework for service standards in all its voted grant and contribution programs as well as those under Part II of the *Employment Insurance Act*.

5.386 We found that the administrative work needed to deliver grant and contribution programs has increased due to several factors, including the new requirements of the file model. In addition, our interviews with management and project officers at the regional and local levels indicate that staff have become more risk-averse. In other words, work proceeds more slowly because staff may be worried about making mistakes. This may explain to some extent why the Department lapsed about $140 million of grant and contribution funds in 2000–01, an increase of about $70 million over the previous year.

5.387 The Department has recognized the need to constantly examine and reduce paperburden while ensuring that controls are sound. It has taken some steps recently to ensure that administrative and financial requirements are commensurate with the risk profile of programs and projects. For instance, it developed a detailed administrative streamlining workplan for July to December 2001. It has also started to streamline its practices and tools in order to reflect risk management principles. In particular, in late June 2001 it introduced a streamlined, generic contribution project file and grant model file in one program. The Department is developing streamlined model files for all its voted grant and contribution programs.

5.388 In 2000, the Standing Committee on Human Resources Development and the Status of Persons with Disabilities asked the Auditor General to provide guidance "on ways to balance efficiency and flexibility in terms of program delivery and the need for sound financial management." In our October 2000 Report we noted, "Not all grant and contribution programs are of equal risk, nor are all projects in a program." We also acknowledged that "there is no simple answer to what the ideal balance should be." However, we believe that the use of comprehensive risk management frameworks is critical to reducing undue paperburden and improving the quality of services to Canadians while maintaining sound financial control. Management informed us that the Department recently started to develop such frameworks in collaboration with the Treasury Board Secretariat, with a view to managing grant and contribution projects more efficiently and effectively. We encourage the Department to sustain those efforts.

5.389 The Committee's report contained about 30 recommendations, 20 of which were addressed to HRDC. Exhibit 5.8 summarizes the Department's progress in acting on those recommendations. We note that HRDC has made good progress or has fully addressed the Committee's recommendations relating to the Department.

Exhibit 5.8 Human Resources Development Canada's progress in implementing recommendations of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, 31 July 2001

Quality assurance measures		
3. HRDC should better integrate financial managers into its program design and delivery operations. To ensure that program managers adhere to proper financial standards and procedures, greater oversight must be part of the changing role of the financial community if HRDC is to achieve higher levels of prudence and probity.	◓	11.149 The Department should put in place quality control measures to review corrective actions, and ongoing monitoring to ensure that staff has a solid understanding of the fundamentals of financial control. Using such an approach, the Department should ensure that all overpayments from problem files and high-risk dormant files are properly identified and recovered.
13. HRDC should utilize the necessary financial expertise, whether internal or external, to assess and approve financial proposals and business plans.	●	
14. HRDC staff should apprise all project sponsors of the importance of meeting the objectives and outcomes of grants and contributions, their obligations under contribution agreements and the consequences of failing to meet these.	●	
15. HRDC should consider imposing a moratorium on providing funds to project sponsors who do not comply with the terms and conditions of their funding arrangements.	●	
Strengthening key controls		
1. The *Performance Report* of the Department of Human Resources Development should provide detailed annual information to Parliament and the public about how the commitments in *Strengthening Grants and Contributions at HRDC* have ensured that payments to recipients of grants and contributions meet financial and program requirements.	◓ (Annual reporting)	11.150 The Department should ensure that key controls are strengthened as it committed to do in the Six-Point Action Plan and that they are supported by a strong internal audit function that meets the highest professional standards. The Department should also ensure that it has a well-established system for implementing and following up on corrective action resulting from internal audits.
18. HRDC should ensure that organisations receive money according to their grant or contribution agreement in a timely manner. The Department should guard against over-compensating for the shortcomings found in the 1999 internal audit with a reactive return to unnecessary red tape.	◓	
22. HRDC should continue to operate its National Grants and Contributions Performance Tracking Directorate until it observes, for a sufficient period of time, results that are within established acceptable performance levels. Thereafter, the Internal Audit Bureau should conduct a bi-annual audit of these grants and contributions.	◓	
23. To enhance public confidence, HRDC should ensure that it meets the deadlines contained in its *Action Plan*, and that the public be fully informed, in a timely manner, of HRDC's progress in improving the administration of grants and contributions.	◓	

● Fully addressed ◓ Satisfactory progress ○ Unsatisfactory progress

---

[1] *Seeking a Balance: Final Report on Human Resource Development Canada Grants and Contributions*, Report of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, June 2000.

[2] 2000 Report of the Auditor General of Canada, Chapter 11, Human Resources Development Canada—Grants and Contributions.

Program management study		
16. In negotiating agreements under what the Auditor General of Canada calls "collaborative arrangements," HRDC (and other government departments) should ensure that each party receiving federal funds is subject to clearly defined and enforceable requirements to report on, evaluate and audit this spending.	●	11.151 The Department should complete its study of program management, which is designed to ensure that desired results of grant and contribution programs are clearly defined and that results are appropriately measured and used to identify any necessary changes. In consultation with the Treasury Board Secretariat, the Department should ensure that it meets its proposed time frame for analysing the objectives of all its grant and contribution programs and implementing appropriate changes, including measurement of results.
Equality of access		
6. To promote transparency, HRDC should ensure that it has an information system accessible to the public on the departmental Web site that provides details about individual grant and contribution programs.	●	11.152 The Department should assess whether the information it provides to Canadians on grant and contribution programs adequately promotes equality of access, and it should take corrective action as required.
10. HRDC should ensure that eligibility criteria governing access to all of its programs are clearly identified, adequately communicated and applied equitably across the country.	◓	
Equip and support staff		
2. HRDC should ensure that it has the necessary expertise to administer grant and contribution programs and that the department allocates more resources to hiring and training financial administrators with appropriate educational and professional qualifications.	●	11.153 The Department should ensure that management sustains its current strong support for change to ensure that actions to equip and support staff are fully implemented and the required tools and systems provided. It should conduct ongoing monitoring of the impacts of the new tools and training and the concepts and approaches being implemented. It should also ensure that the new information system for grants and contributions is fully integrated with the Department's financial system.
5. HRDC should give a higher priority to the Department's three-year plan to develop a system that tracks the performance history of project sponsors and a system that integrates the Department's financial and administrative systems. The plan should be put in place sooner than the three years promised in the Action Plan.	◓	

● Fully addressed ◓ Satisfactory progress ○ Unsatisfactory progress

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[1] *Seeking a Balance: Final Report on Human Resource Development Canada Grants and Contributions*, Report of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, June 2000.

[2] 2000 Report of the Auditor General of Canada, Chapter 11, Human Resources Development Canada—Grants and Contributions.

Exhibit 5.8 Human Resources Development Canada's progress in implementing recommendations of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, 31 July 2001

Standing Committee recommendations[1]	Our assessment	Links with Auditor General's 2000 Report[2]
Quality assurance measures		
3. HRDC should better integrate financial managers into its program design and delivery operations. To ensure that program managers adhere to proper financial standards and procedures, greater oversight must be part of the changing role of the financial community if HRDC is to achieve higher levels of prudence and probity.	◓	11.149 The Department should put in place quality control measures to review corrective actions, and ongoing monitoring to ensure that staff has a solid understanding of the fundamentals of financial control. Using such an approach, the Department should ensure that all overpayments from problem files and high-risk dormant files are properly identified and recovered.
13. HRDC should utilize the necessary financial expertise, whether internal or external, to assess and approve financial proposals and business plans.	●	
14. HRDC staff should apprise all project sponsors of the importance of meeting the objectives and outcomes of grants and contributions, their obligations under contribution agreements and the consequences of failing to meet these.	●	
15. HRDC should consider imposing a moratorium on providing funds to project sponsors who do not comply with the terms and conditions of their funding arrangements.	●	
Strengthening key controls		
1. The *Performance Report* of the Department of Human Resources Development should provide detailed annual information to Parliament and the public about how the commitments in *Strengthening Grants and Contributions at HRDC* have ensured that payments to recipients of grants and contributions meet financial and program requirements.	◓ (Annual reporting)	11.150 The Department should ensure that key controls are strengthened as it committed to do in the Six-Point Action Plan and that they are supported by a strong internal audit function that meets the highest professional standards. The Department should also ensure that it has a well-established system for implementing and following up on corrective action resulting from internal audits.
18. HRDC should ensure that organisations receive money according to their grant or contribution agreement in a timely manner. The Department should guard against over-compensating for the shortcomings found in the 1999 internal audit with a reactive return to unnecessary red tape.	◓	
22. HRDC should continue to operate its National Grants and Contributions Performance Tracking Directorate until it observes, for a sufficient period of time, results that are within established acceptable performance levels. Thereafter, the Internal Audit Bureau should conduct a bi-annual audit of these grants and contributions.	◓	
23. To enhance public confidence, HRDC should ensure that it meets the deadlines contained in its *Action Plan*, and that the public be fully informed, in a timely manner, of HRDC's progress in improving the administration of grants and contributions.	◓	

● Fully addressed ◓ Satisfactory progress ○ Unsatisfactory progress

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Standing Committee recommendations[1]	Our assessment	Links with Auditor General's 2000 Report[2]
Program management study		
16. In negotiating agreements under what the Auditor General of Canada calls "collaborative arrangements," HRDC (and other government departments) should ensure that each party receiving federal funds is subject to clearly defined and enforceable requirements to report on, evaluate and audit this spending.	●	11.151 The Department should complete its study of program management, which is designed to ensure that desired results of grant and contribution programs are clearly defined and that results are appropriately measured and used to identify any necessary changes. In consultation with the Treasury Board Secretariat, the Department should ensure that it meets its proposed time frame for analysing the objectives of all its grant and contribution programs and implementing appropriate changes, including measurement of results.
Equality of access		
6. To promote transparency, HRDC should ensure that it has an information system accessible to the public on the departmental Web site that provides details about individual grant and contribution programs.	●	11.152 The Department should assess whether the information it provides to Canadians on grant and contribution programs adequately promotes equality of access, and it should take corrective action as required.
10. HRDC should ensure that eligibility criteria governing access to all of its programs are clearly identified, adequately communicated and applied equitably across the country.	◓	
Equip and support staff		
2. HRDC should ensure that it has the necessary expertise to administer grant and contribution programs and that the department allocates more resources to hiring and training financial administrators with appropriate educational and professional qualifications.	●	11.153 The Department should ensure that management sustains its current strong support for change to ensure that actions to equip and support staff are fully implemented and the required tools and systems provided. It should conduct ongoing monitoring of the impacts of the new tools and training and the concepts and approaches being implemented. It should also ensure that the new information system for grants and contributions is fully integrated with the Department's financial system.
5. HRDC should give a higher priority to the Department's three-year plan to develop a system that tracks the performance history of project sponsors and a system that integrates the Department's financial and administrative systems. The plan should be put in place sooner than the three years promised in the Action Plan.	◓	

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[1] *Seeking a Balance: Final Report on Human Resource Development Canada Grants and Contributions*, Report of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, June 2000.

[2] 2000 Report of the Auditor General of Canada, Chapter 11, Human Resources Development Canada—Grants and Contributions

Standing Committee recommendations[1]	Our assessment	Links with Auditor General's 2000 Report[2]
7. HRDC should commission an evaluation of its managerial staffing practices, by a private sector management consulting firm, with a view to improving and supporting managerial continuity and stability in National Headquarters and regional offices throughout the country.	●	
8. HRDC should treat staffing needs, including training, as one of its highest priorities to enhance administration of grants and contributions. Moreover, the acquisition of additional financial resources to meet these needs should be identified immediately and secured from HRDC's existing budget, and recouped through supplementary estimates.	●	
9. HRDC should provide the necessary training to project officers to permit them to educate and assist third-party project sponsors in terms of departmental expectations, and program rules and guidelines.	◓	
12. HRDC should put in place more comprehensive contribution agreements that outline performance expectations, financial rules and penalties in the event of non-compliance.	●	
Balancing Control and Service		
17. HRDC should not reverse the decentralization of its grant and contribution programmes to regional offices. The objectives of sound administration, transparency, and accountability can and should be addressed within the context of regional and local operations that are best able to respond to local needs.	●	11.385 There is no simple answer to what the ideal balance should be. It is essential that key controls be in place and minimum standards observed. That these controls are a requirement needs to be spelled out clearly and understood by staff. Then public servants have the foundation to innovate in the delivery of programs and to strike the most appropriate balance between efficiency and flexibility in program delivery and sound financial management.
19. HRDC should strengthen its internal lines of reporting and monitoring to ensure that the delegation of administration and management to regional offices and headquarters is balanced with appropriate measures to ensure accountability.	◓	
20. By 1 June 2001, HRDC should report to this Committee on how it has struck a balance between decentralisation, flexibility and control.	●	

● **Fully addressed.** The recommendation has been fully addressed and there is no need to take additional action.

◓ **Satisfactory progress.** The department has made good progress in addressing the recommendation, but some additional action is still required.

○ **Unsatisfactory progress.** Progress has not been made in addressing the recommendation, and action remains outstanding.

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About the Audits

Objectives

The objective of our detailed audits was to determine whether departments had adequate control over selected grant and contribution programs.

The objective in our follow-up of previous recommendations was to determine what departments had done to implement corrective action.

Scope and approach

We attempted to select programs for audit that would capture as many of the key features of grants and contributions as possible, including kind of recipient, delivery mechanism, duration of project funding, policy area, size of department, burden of cost. To that end, we selected the following programs for audit at these departments:

- Agriculture and Agri-Food Canada—Agri-Food Trade Program
- Canada Economic Development for Quebec Regions—IDEA-SME Program and Regional Strategic Initiatives
- Canadian Institutes for Health Research—Operating Grants Program
- Citizenship and Immigration Canada—Settlement Contribution Programs
- Department of Canadian Heritage—Support for Official-Language Communities
- Environment Canada and Natural Resources Canada—Contributions made under the Climate Change Action Fund
- Solicitor General Canada—First Nations Policing Program
- Western Economic Diversification Canada—Community Futures program

We also followed up on the following previous audits of grant and contribution programs:

- Department of Canadian Heritage—Grants and Contributions Under the Multiculturalism Program (Chapter 27, 1998)
- Industry Portfolio: Investing in Innovation (Chapter 19, 1999)
- Human Resources Development Canada—Grants and Contributions (Chapter 11, 2000)

In addition to examining the management of individual projects under each program, we assessed the design of the programs and the measurement of project and program performance. We chose the projects that we audited under each program so the results of our audit could be extended to the program's expenditures during the sampled period. The specific period is indicated with each description of the programs audited.

In all programs, we reviewed project files and documents for our audit criteria and interviewed project officers and others involved in managing the projects and the programs. We also visited selected regions, projects, and funding recipients in some programs.

Criteria

Where we carried out detailed audits, we expected that departments would do the following:

- comply with authorities;
- ensure that grant and contribution programs are designed to achieve expected results, manage risks, ensure due diligence in spending, and provide accountability for public funds spent;
- exercise due diligence in approving individual grants and contributions;
- have reasonable assurance that the funding is used for the purposes intended;
- know whether programs are achieving expected results;

- report clearly to Parliament on program performance;
- reinforce public sector values and value for money attitudes among program staff; and
- make reasonable efforts to harmonize and co-ordinate their activities with other organizations delivering similar programs.

Audit team

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Report of the Auditor General of Canada to the House of Commons—2001

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to the House of Commons

Chapter 6

Atlantic Canada Opportunities Agency—Economic Development

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

6

Atlantic Canada Opportunities Agency

Economic Development

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Atlantic Canada Opportunities Agency
Economic Development

Main Points

6.1 We found that the Agency has used due diligence in approving, assessing, and monitoring commercial projects and in managing its portfolio of repayable contributions. The Agency's assessment of commercial projects has become more rigorous since our last audit in 1995. However, it has not reported publicly on its performance in managing $400 million of repayable contributions.

6.2 The objectives and expected results of non-commercial projects and federal-provincial agreements are often stated vaguely. In the absence of clear, concrete expected results, it is difficult to determine the rate of progress and the success of these projects.

6.3 Increasingly, the Agency uses partnerships and alliances with other levels of government and not-for-profit organizations to fulfil its mandate for economic development. But it does not have a consistent overall approach to managing these partnerships. Nor has it evaluated the cost effectiveness of partnerships and alliances as a means of delivering its programs.

6.4 Management controls over practices common to both commercial and non-commercial projects were satisfactory, except for the following:

- The Agency has not developed a strategy to implement its policy against providing core funding beyond three years to not-for-profit organizations.
- Its letters of offer to recipients of funding did not include some key provisions required by the Treasury Board and designed to protect the government's interest.
- Potential environmental impacts were not considered as an integral part of decisions to approve projects.

6.5 The Agency reports a great deal of performance information publicly, most of it supported by reasonable evidence. It has established specific results it expects for many objectives. However, the accuracy and relevance of the employment impact it has reported for non-commercial projects are questionable.

Background and other observations

6.6 The Atlantic Canada Opportunities Agency (ACOA) provides financial support to a wide variety of projects. Commercial projects are intended to help businesses increase profits or expand. Assistance for non-commercial projects generally goes to other levels of government or to not-for-profit organizations for projects intended to assist "enabling" projects that have a long-term or indirect impact.

6.7 ACOA is the federal government's lead agency for co-ordinating and carrying out activities to support economic development in Atlantic Canada. It works with a variety of organizations, including federal departments, provincial governments, not-for-profit organizations, and businesses.

6.8 ACOA spent $283 million in 2000–01, $266.6 million of it on its development business line. The programs in this business line have a range of objectives, provide different types of financial assistance, and are delivered by a variety of methods.

The Agency has responded. The Atlantic Canada Opportunities Agency's responses to our recommendations are included in this chapter. The Agency agrees with the recommendations and indicates the actions that it is taking or intends to take to address them.

Introduction

The Agency's mandate

6.9 The Atlantic Canada Opportunities Agency (ACOA) was created in 1987 to co-ordinate and carry out the federal government's economic development initiatives in Atlantic Canada.

6.10 The Agency's mandate, set out in the *Atlantic Canada Opportunities Agency Act*, is "to increase opportunity for economic development in Atlantic Canada and, more particularly, to enhance the growth of earned incomes and employment opportunities in the region." In its 2001–02 *Report on Plans and Priorities*, the Agency has translated this mandate into its overall objective:

> To support and promote new opportunities for economic development in Atlantic Canada, with particular emphasis on small- and medium-sized enterprises (SMEs) through policy, program and project development and implementation and through advocating the interests of Atlantic Canada in national economic policy, program and project development and implementation.

What is economic development?

6.11 Economic development is the enhancement of one or more of the factors that affect productivity—land, labour, capital, and technology. It can be promoted nationally, provincially, or locally. Governments stimulate economic development by using their resources to reduce risks or costs that limit investment by the private sector; thus, they encourage investment in specific locations or activities they consider desirable.

6.12 Governments can take any number of approaches to economic development, including the following:

- attract industries through recruitment and marketing;
- make local areas more attractive to investors by improving infrastructure;
- focus on specific industrial sectors;
- focus on exporting; and
- promote innovation as a basis of growth.

6.13 Economic development activities take many forms. Examples are direct subsidies to individual businesses; tax policy and incentives; support to cultural, intellectual, or related infrastructure; and government policies that encourage private sector investment or investment in the social well-being and health of a community. Economic development entails a variety of approaches, forms, and potential outcomes. It is important that organizations promoting it set priorities and identify the successful outcomes they expect.

6.14 Economic development is pursued throughout the developed world. Canadian provinces, American states, the European Union, and many municipalities create financial incentives and policies to encourage investment. The Agency's support of economic development in Atlantic Canada is similar to that given by government agencies throughout the world.

6.15 ACOA's approach to economic development encompasses the following:

- different delivery methods (direct federal delivery, shared delivery with other levels of government, delivery with and through other parties);
- different forms of financial assistance (repayable, provisionally repayable, and non-repayable); and
- different program goals (a focus on small and medium-sized enterprises or rural communities, adjustment to address specific industry concerns, or development of community infrastructure).

6.16 This means that the Agency supports a wide variety of projects and activities. The majority of ACOA funding goes to not-for-profit organizations or governments as non-repayable contributions. Businesses that receive assistance are usually expected to repay it. Exhibit 6.1 shows the wide range of activities that ACOA supported in 2000–01.

Focus of the audit

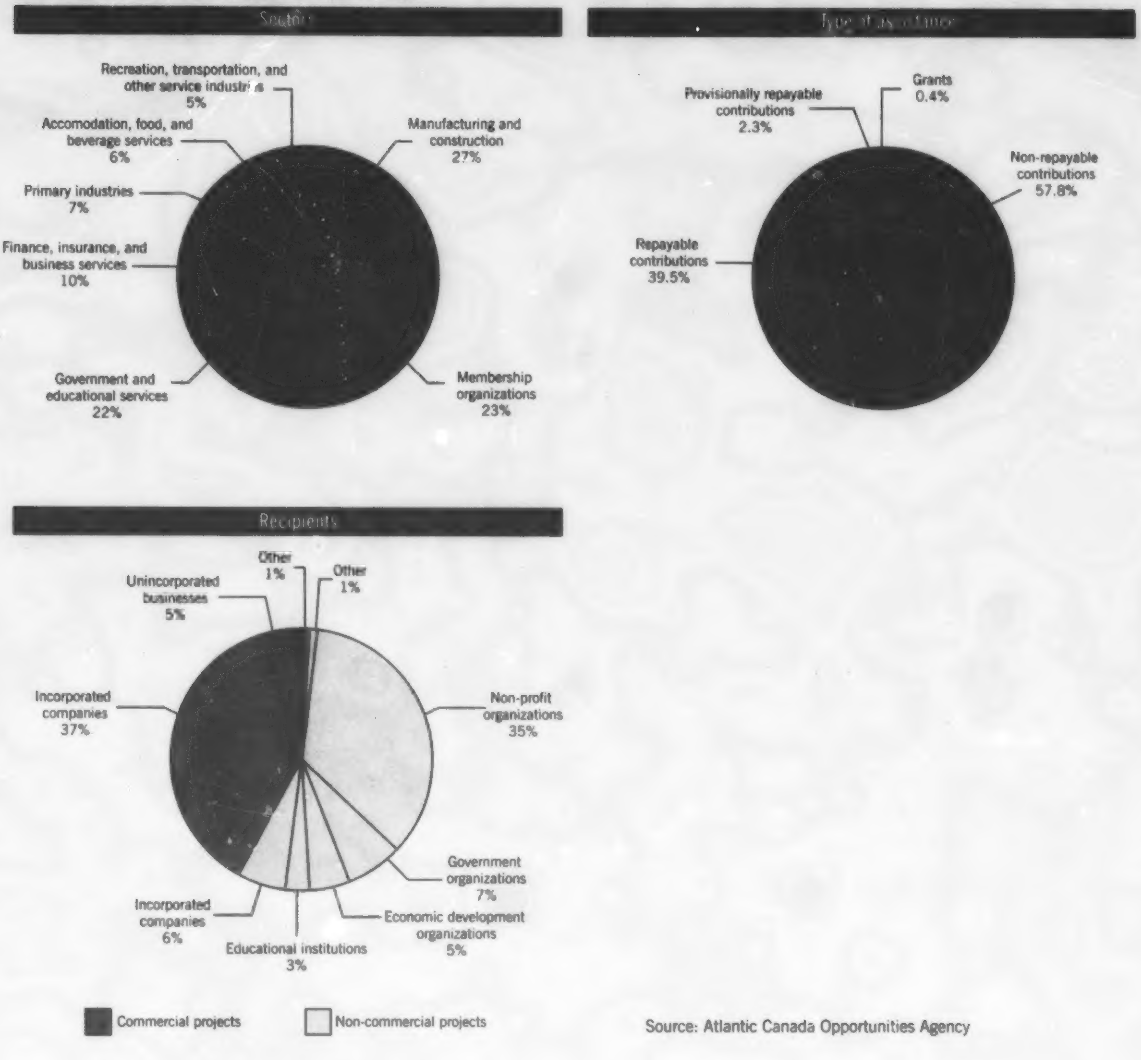
6.17 We undertook this audit to assess how well the Agency's programs reflect its mandate, objectives, and priorities. We also looked at the design and implementation of its framework for controlling its key economic development programs. We looked for compliance with key authorities, such as the *Financial Administration Act*, the *Canadian Environmental Assessment Act*, and Treasury Board policies and guidelines. Finally, we wanted to know how relevant, accurate, balanced, and meaningful its performance information is and to what extent the results it claims can be attributed to the Agency's activities. About the Audit at the end of the chapter has more details.

6.18 Using a sample of projects approved between 1 April 1999 and 31 January 2001, we were able to assess how ACOA managed its activities throughout the project life cycle—assessing and approving applications, monitoring and disbursing funds, and evaluating project results. Our sample included all projects approved under the Business Development Program in this period with authorized funding of over $500,000. It also included from other programs all projects with funding of over $2.5 million. And we examined a representative sample of all other projects approved under the Business Development Program and other programs in the same period. The total sample included 40 commercial projects and 68 non-commercial projects.

6.19 We also examined how the Agency measured and reported key information on its performance.

Exhibit 6.1 The Agency supported a wide range of activities in 2000–01

Total assistance authorized in 2000–01 was $218 million



Source: Atlantic Canada Opportunities Agency

Observations and Recommendations

The Agency's programs reflect its mandate, objectives, and priorities

6.20 [illegible]

Exhibit 6.2 The Agency's key results commitments

To provide Canadians with the following:	Strategic priorities
Improved growth and competitiveness of Atlantic small and medium-sized enterprises, leading to increased productivity, earned incomes, and job creation	Access to capital and information Entrepreneurship and business skills development Innovation Trade, tourism, and investment
Economic opportunities [illegible] of Atlantic Canada through community economic development	Community economic development
[illegible]	Policy, advocacy, and coordination

[illegible]

[illegible]

ACOA's framework for controlling grants and contributions is generally appropriate

[illegible]

- [illegible]
- [illegible]
- [illegible]
- [illegible]
- [illegible]

6.24 We reviewed this framework against the requirements of the Treasury Board's Policy on Transfer Payments, the *Financial Administration Act*, the *Atlantic Canada Opportunities Agency Act*, and the *Canadian Environmental Assessment Act*. Except for concerns about letters of offer and environmental assessments, we found that the framework for controlling grants and contributions is appropriate. However, as noted in other sections of this chapter, in some areas the Agency has not applied components of this framework adequately.

Exhibit 6.3 The Agency's grant and contribution programs

	Spending ($ millions)		
Grant and contribution program	**2000–01 forecast**	**2001–02 planned**	**Nature of the program**
Business Development Program	111.0	123.0	Offers access to capital in the form of interest-free, unsecured, repayable, provisionally repayable, and non-repayable contributions, with a focus on small and medium-sized enterprises.
COOPERATION Program	27.7	45.0	Federal-provincial cost-shared agreements designed to improve the environment for economic growth. Provides non-repayable contributions to commercial and non-commercial projects.
Community Futures Program	10.6	10.6	Annual operating and investment contributions to community business development corporations.
Economic development component of the Canadian Fisheries Adjustment and Restructuring Initiative	33.5	41.4	Contributions to assist affected fishing communities become more self-reliant by diversifying and expanding their economies.
The Atlantic Groundfish Strategy	19.7	4.5	Contributions to new initiatives for developing new employment opportunities in response to the downturn in the groundfish industry.
Infrastructure Canada Program	8.1	37.8	Federal, provincial, and municipal cost-shared agreements to assist with municipal and community infrastructure.
Miscellaneous adjustment programs	5.9	4.4	Assistance to communities facing adjustment as a result of economic and social events that have significant impacts on employment.
Atlantic Investment Partnership		81.1	Contributions for applied research and development, and contributions to assist in developing partnerships that will increase the capacity of Atlantic Canadian businesses to compete and to grow in the knowledge-based economy.
Total	**216.5**	**343.8**	

Observations and Recommendations

Program design

The Agency's programs reflect its mandate, objectives, and priorities

6.20 The Agency's mandate is "to increase opportunity for economic development in Atlantic Canada." Its 2001–02 *Report on Plans and Priorities* shows that it plans to do this by achieving key results commitments, focussing on related strategic priorities (Exhibit 6.2).

Exhibit 6.2 The Agency's key results commitments

[illegible]	[illegible]
Improved growth and competitiveness of Atlantic small and medium-sized enterprises, leading to increased productivity, earned incomes, and job creation.	Access to capital and information Entrepreneurship and business skills development Innovation Trade, tourism, and investment
Economic opportunities for rural Atlantic Canada through community economic development.	Community economic development
Greater economic activity in Atlantic Canada through national policies sensitive to the needs of the region.	Policy, advocacy, and co-ordination

Source: Atlantic Canada Opportunities Agency, 2001–02 *Report on Plans and Priorities*

6.21 ACOA uses its development business line to meet its key results commitments. This business line includes grant and contribution programs, policy development, advocacy of Atlantic Canada's interests, and co-ordination of government activities in the region.

6.22 The Agency's grant and contribution programs are designed to provide direct support to commercial projects and non-commercial organizations that in turn provide support to businesses in Atlantic Canada (Exhibit 6.3). Our audit found that the programs are consistent with the Agency's mandate, objectives, and strategic priorities.

Project controls

ACOA's framework for controlling grants and contributions is generally appropriate

6.23 The Agency's control over its programs and activities is based primarily on the following:

- the requirements of the *Atlantic Canada Opportunities Agency Act*;
- program terms and conditions or federal-provincial agreements approved by the Treasury Board;
- ACOA's internal policies, procedures, and controls;
- internal audits, evaluations, and reviews; and
- internal and external reporting.

6.24 We reviewed this framework against the requirements of the Treasury Board's Policy on Transfer Payments, the *Financial Administration Act*, the *Atlantic Canada Opportunities Agency Act*, and the *Canadian Environmental Assessment Act*. Except for concerns about letters of offer and environmental assessments, we found that the framework for controlling grants and contributions is appropriate. However, as noted in other sections of the chapter, in some areas the Agency has not applied components of this framework adequately.

Exhibit 6.3 The Agency's grant and contribution programs

[redacted]	[redacted]	[redacted]	[redacted]
Business Development Program	111.0	123.0	Offers access to capital in the form of interest-free, unsecured, repayable, provisionally repayable, and non-repayable contributions, with a focus on small and medium-sized enterprises.
COOPERATION Program	27.7	45.0	Federal-provincial cost-shared agreements designed to improve the environment for economic growth. Provides non-repayable contributions to commercial and non-commercial projects.
Community Futures Program	10.6	10.6	Annual operating and investment contributions to community business development corporations.
Economic development component of the Canadian Fisheries Adjustment and Restructuring Initiative	33.5	41.4	Contributions to assist affected rural communities become more self-reliant by diversifying and expanding their economies.
The Atlantic Groundfish Strategy	19.7	5.1	Contributions to help communities develop long-term employment opportunities in response to the downturn in the groundfish industry.
Infrastructure Canada Program	8.1	30.8	Federal, provincial, and municipal cost-shared agreements designed to improve community infrastructure.
Miscellaneous adjustment programs	5.9	4.4	Assistance to communities to develop alternative sources of employment where traditional industries have suffered a downturn.
Atlantic Investment Partnership	–	83.5	Conditionally repayable and non-repayable contributions to assist in building new partnerships that will increase the capacity of Atlantic Canadians to compete in an increasingly global, knowledge-based economy.
[redacted]	[redacted]	[redacted]	[redacted]

Source: Atlantic Canada Opportunities Agency, 2001–02 *Report on Plans and Priorities*

Letters of offer are missing some required conditions

6.25 When accepted by a project proponent, the letter of offer is a contribution agreement between ACOA and the proponent. The letter of offer spells out the following:

- the activities both parties are expected to carry out;
- the results expected from the contribution;
- the legislation and government policies the proponent is expected to comply with;
- any limits or special circumstances;
- the type and amount of financial assistance ACOA will provide; and
- the terms of repayment, where applicable.

6.26 We found that the letters of offer we reviewed met most of the requirements for contribution agreements set out in Treasury Board's Policy on Transfer Payments. However, they did not include the following required elements:

- a clause to limit the government's liability if the recipient borrows additional money elsewhere for the project;
- a provision to cancel or reduce transfer payments if Parliament changes departmental funding levels;
- a requirement that the recipient declare any amounts it owes the federal government and recognize that amounts to be paid to the recipient may be used to pay other debts to the government;
- a requirement that no current or former public office holder or public servant shall derive a direct benefit from the agreement, except as provided for in the Conflict of Interest and Post-Employment Code for Public Office Holders and the Conflict of Interest and Post-Employment Code for the Public Service; and
- a requirement that any person lobbying on behalf of the project proponent be registered under the *Lobbyists Registration Act*.

These terms are all required by the Treasury Board Policy on Transfer Payments.

6.27 Further, we noted that the letters of offer for 17 projects in our sample did not describe the results expected in return for the contribution, also a requirement of the Treasury Board Policy on Transfer Payments. The Agency's standard letter of offer does not require a statement of expected results.

6.28 **Recommendation.** The Agency should amend its standard letter of offer to ensure that it provides for a statement of the specific results the project is expected to achieve and that it includes the provisions required by the Treasury Board and designed to protect the government's interest.

Agency's response. Concur. In recognition of this recommendation and the new Treasury Board Policy on Transfer Payments, the Agency has made several changes to the standard letter of offer. In some instances, we also have undertaken work with the Treasury Board Secretariat to develop wording that is in compliance with the transfer payment policy and is acceptable to our clients.

Environmental assessments are not an integral part of decision making

6.29 The *Canadian Environmental Assessment Act* (CEAA) requires federal departments, including ACOA, to carry out an environmental assessment of every project that receives federal funds. This assessment must be done before the funds are approved. In ACOA's experience, a proposal to fund the construction or expansion of a facility or related infrastructure is the kind most likely to trigger an environmental assessment.

6.30 Of the 108 projects in our sample, ACOA officials had identified 26 that required an environmental assessment under the CEAA. We found that the Agency had carried out the assessments that were required. We also reviewed the project files of the 82 other projects in our sample to confirm that they had not required environmental assessments.

6.31 **Weaknesses in the way ACOA performs environmental assessments.** From our review of the 26 environmental assessments the Agency conducted, we have the following concerns:

- In seven cases, ACOA carried out the environmental assessment after giving effective approval to the project. The CEAA requires that environmental assessments be carried out before a federal department does anything that commits it to a project, such as agreeing to provide financial assistance. In many other cases, the Agency carried out the environmental assessment late in the approval process. In our view, if an environmental assessment is to serve as an effective tool for decision making, it must be an integral part of assessing the project proposal.
- In 12 cases, the letter of offer did not include a condition requiring the applicant to implement all of the mitigation measures identified in the environmental assessment. If ACOA is to meet its obligations under the CEAA, its letters of offer to proponents must include any mitigation measures that are required.
- The environmental assessments of seven projects identified the need for subsequent follow-up. In four of these cases, ACOA did not follow up on the concerns it had identified.

6.32 The 1998 Report of the Commissioner of the Environment and Sustainable Development (Chapter 6) criticized ACOA for tending to conduct environmental assessments only after all other factors in a project's approval had been considered. That this practice continues in 2001 is worrisome.

6.33 The case study on page 10 illustrates some of our concerns about ACOA's approach to environmental assessments. It still does not include as an integral part of its project management process the environmental assessment of the project and subsequent follow-up to ensure that the proponent has taken any required mitigation measures.

6.34 **Recommendation.** The Agency should ensure that it integrates environmental assessments with the project approval process. Its letters of offer should include mitigation measures identified by environmental

assessments. The Agency should follow up as required to ensure that the project proponent completes the mitigation measures.

Agency's response. Agree. ACOA is committed to environmentally friendly, sustainable development. We will review our project approval process to re-affirm the requirement for more consistent application of environmental assessments. We will ensure that mitigation measures emanating from the environmental assessments are included in 100 percent of letters of offer, and we will ensure appropriate monitoring of their completion by the client.

Environmental assessments are not an integral part of the Agency's decision making

In April 1998, the Agency received a proposal for the development of a hotel and resort on Prince Edward Island. As part of the approval process, the Agency conducted an environmental assessment of the project. The arrangements with the original proponent did not proceed.

Negotiations were subsequently conducted with another proponent who submitted a funding application to the Agency on 30 October 2000. The Agency decided that a new environmental assessment was required because the scope of the project had changed. This assessment started on 7 February 2001 and was completed in March. A letter of offer was sent to the new proponent on 31 March 2001

One of the measures recommended in the environmental assessment was the development of an environmental protection plan for the construction phase. Construction began in November 2000 and the facility was operating in July 2001. The Agency did not receive an environmental protection plan before operations began. The proponent submitted a claim for payment, but the Agency had not disbursed any funds at July 2001.

We are concerned that the environmental assessment was completed four months after construction started and that, even though the facility is now operating, the Agency has not received an environmental protection plan covering the construction phase.

Source: Atlantic Canada Opportunities Agency

Disbursement of funds and monitoring of projects generally comply with policies

6.35 We found that except for advance payments, the Agency disbursed funds in accordance with the Treasury Board's policies and its own policies. It monitored projects adequately to ensure that they complied with the conditions for funding, except the environmental mitigation measures already noted.

6.36 **Advance payments.** Ten percent of the projects we reviewed did not comply with the advance payment requirements of the Treasury Board Policy on Transfer Payments. In those cases, there was no evidence of the proponent's cash requirements to support the need for advance payment.

Managing non-commercial projects

Many activities are eligible for funding or can be made eligible

6.37 Projects in our sample included non-commercial activities such as developing community infrastructure; planning community-based economic development; holding conferences, workshops, and training; carrying out trade and research studies; and others. This shows the wide range of activities assessments. The Agency should follow up as required to ensure that the project proponent completes the mitigation measures.

Agency's response. Agree. ACOA is committed to environmentally friendly, sustainable development. We will review our project approval process to re-affirm the requirement for more consistent application of environmental assessments. We will ensure that mitigation measures emanating from the environmental assessments are included in 100 percent of letters of offer, and we will ensure appropriate monitoring of their completion by the client.

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Managing non-commercial projects

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6.37 Projects in our sample included non-commercial activities such as developing community infrastructure; planning community-based economic development; holding conferences, workshops, and training; carrying out trade and research studies; and others. This shows the wide range of activities that fit or can be made to fit the Agency's program terms and conditions, guidelines, agreement objectives, and strategic priorities. Given the range of ACOA's programming and the breadth of its strategic priorities, we question whether eligibility criteria are explicit enough to provide guidance for a decision to approve a project or not.

6.38 All the non-commercial projects in our sample were eligible under the terms and conditions approved by the Treasury Board or the objectives of individual federal-provincial agreements and the Agency's program guidelines. However, we also found that for large non-commercial projects, the Agency or the management committee for a federal-provincial agreement can either override policy requirements or have applicants change their project proposals to conform to existing requirements.

6.39 For example, two multi-purpose centres were approved for funding under the Canada/Nova Scotia COOPERATION Agreement on Economic Diversification. The centres do not fall under any of ACOA's strategic priorities. In fact, the Secretary of State responsible for the Agency originally rejected both proposals because, as basic civic infrastructure, the centres were not eligible for the funding.

6.40 For one of the centres, ACOA did not provide cash but agreed that the total expenditure would be credited to the Province's share of funding under the Agreement. Therefore, ACOA must "make up" the amount elsewhere under the Agreement. The proposal for the other centre was revised with the Agency's help to include additional facilities that put it within the scope of the Agreement.

6.41 We also noted the use of questionable means to make a project eligible for a contribution from the Business Development Program. The activities of this project are normally the responsibility of another federal department. Under the terms and conditions approved by the Treasury Board for the Business Development Program, ACOA is not permitted to provide financial assistance for government services. Agency officials were instrumental in creating a not-for-profit organization, known as Greenwich Development Inc. (GDI), to contract with private sector developers for the complete development of an interpretation centre in Greenwich, PEI, adjacent to the National Park boundary. ACOA officials then acted in management capacities for this organization by entering into contracts, making claims to ACOA, and disbursing funds on behalf of GDI. In our view, these actions circumvented the intent of the terms and conditions of the Business Development Program. The case also illustrates the difficulty of determining how much a project's total funding is from the government when many partners are involved (see case study on page 12).

Many projects are not financially sustainable in the long run

6.42 The Business Development Program has a policy against providing core operating funding beyond three years to not-for-profit organizations, except with the President's approval. The Agency believes that three years should be long enough for an organization to become financially self-sustaining. Of the 28 non-commercial Business Development Program projects we audited, we found 3 that, although properly approved, received

Making a project eligible using questionable means

In 1998 Parks Canada began assembling land near Greenwich, Prince Edward Island to incorporate a sensitive dune area into the Prince Edward Island National Park and to provide opportunities to visitors to learn about its significance. A number of partners then became involved in funding and developing aspects of the new Greenwich component of the park. For example, the Atlantic Canada Opportunities Agency (ACOA), Parks Canada, and Human Resources Development Canada provided about $1.9 million to the local Community Futures Program group to build park infrastructure such as trails and boardwalks.

In October 1999, ACOA recruited a Board of Directors to form a not-for-profit organization called Greenwich Development Inc. (GDI). This organization was responsible for contracting with private sector developers for the complete development of an interpretation centre in Greenwich, PEI, adjacent to the National Park boundary. The organization has a volunteer Board of Directors but its activities are managed by ACOA officials.

To build the centre and exhibits, Greenwich Development Inc. did the following:

- leased 9.8 hectares of land from Parks Canada;
- selected a builder for the centre;
- sublet the land to the builder;
- received a $1 million contribution from ACOA's Business Development Program for the design and construction of the exhibits; and
- selected and paid a builder for the exhibits.

Officials of ACOA and Parks Canada participated in the selection of the builders of both the centre and the exhibits. In fact, on behalf of GDI, an ACOA official signed the contract with the builder of the exhibits.

We have the following concerns about this type of arrangement:

- Government services are not eligible for funding under the Business Development Program. Although GDI is established as a not-for-profit organization, it is in substance delivering services normally provided by another federal government organization. Creating and operating GDI to receive the contribution therefore circumvents the intent of the terms and conditions of the Business Development Program.
- Because of the complex structure of these arrangements, it is impossible for Parliament to know the full capital and operating costs of the Greenwich component of the park.
- It is inappropriate for ACOA officials to act as officers of recipient organizations, even if authorized by senior ACOA officials.

Source: Atlantic Canada Opportunities Agency

core funding for longer than three years. In addition, 6 other projects funded through other programs were unlikely to be financially sustainable in the future without continued government assistance. Many of these 9 project recipients have depended for many years on funding from ACOA or other federal sources. The Agency does not have a strategy to limit core funding to not-for-profit organizations. In addition, ACOA has not assessed the benefits of providing such long-term support. Exhibit 6.4 indicates a not-for-profit organization that has been dependent on ACOA since it started up in 1989.

Exhibit 6.4 The Canadian Centre for Fisheries Innovation has depended on the Agency for operational and program funding since it opened in 1989

Agency program	Funding period	Approved project cost ($ millions)	Approved assistance ($ millions)
ACOA Action Program	1989–1994	19.1	8.5
ACOA Action Program	1994–2000	14.5	7.2
Canada/Newfoundland Agreement on Economic Renewal	2000–02	2.5	1.5
Canada/Newfoundland Comprehensive Economic Development Agreement	2000–02	2.5	1.0
Total		**38.6**	**18.2**

Source: Atlantic Canada Opportunities Agency

Projects were adequately assessed before approval

6.43 We found reasonable evidence that the Agency is not funding activities that someone other than the project proponent is already carrying out. The projects it has approved, therefore, likely represented no duplication of demand for the limited resources available for economic development.

6.44 We found that the Agency had adequately assessed the capability of project proponents to deliver projects; it had examined its past experience with an applicant and the applicant's reputation, financial capabilities, and management abilities.

6.45 In all of the projects we reviewed, the Agency had considered the likelihood of an economic benefit to Atlantic Canada.

Partnerships and alliances are becoming increasingly important

6.46 ACOA delivers programs increasingly through others or in co-operation with them. It has partnerships and alliances with other federal departments, provincial governments, regional economic development organizations, community business development corporations, educational institutions, and others.

6.47 The Agency is responsible for six active federal-provincial agreements and two Pan-Atlantic agreements, all cost shared. In 2000–01, its share of spending under these agreements was $28 million; it was $54 million in 1999–2000. The amount is declining because the agreements have been expiring.

6.48 Community business development corporations (CBDCs) are autonomous, not-for-profit corporations that provide technical and financial assistance to local entrepreneurs. Technical assistance is usually information,

Making a project eligible using questionable means

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- **Because of the complex structure of these arrangements, it is impossible for Parliament to know the full capital and operating costs of the Greenwich component of the park.**
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Source: Atlantic Canada Opportunities Agency

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[illegible]	[illegible]	[illegible]	[illegible]

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6.47 The Agency is responsible for six active federal-provincial agreements and two Pan-Atlantic agreements, all cost-shared. In 2000–01, its share of spending under these agreements was $28 million; it was $74 million in 1999–2000. The amount is declining because the agreements have been expiring.

6.48 Community business development corporations (CBDCs) are autonomous, not-for-profit corporations that provide technical and financial assistance to local entrepreneurs. Technical assistance is usually information, counselling, and advice to small businesses; financial assistance is usually an interest-bearing loan but can include equity or loan guarantees. In 2000–01, the Agency provided $12.2 million under the Community Futures Program to the 41 CBDCs in the Atlantic region.

6.49 ACOA also supports a network of regional economic development organizations that develop strategic plans for local economic development and then carry them out. In 1999–2000, the 51 regional economic development organizations created by the provincial governments in Atlantic Canada received a total of $6 million from ACOA under federal-provincial agreements.

6.50 We examined the Agency's agreements and relationships with its partners to determine whether they had an effective governing framework, as described in our 1999 Report, Chapter 5, Collaborative Arrangements: Issues for the Federal Government, and Chapter 23, Involving Others in Governing: Accountability at Risk. In particular, we looked for the following:

- credible reporting—including expected and actual results;
- effective accountability mechanisms—including clear roles and responsibilities;
- transparency; and
- protection of the public interest.

6.51 We found the following:

- The results expected from these arrangements were often stated vaguely and not focussed on the longer-term expected outcomes.
- The outcomes of most partnerships were not measured, and the Agency needs to do more to evaluate the reasonableness of claimed results in certain partnerships.
- ACOA has provided little guidance to its staff on managing relationships with partners.
- Partnership arrangements are transparent and include mechanisms to protect the public interest.

Expected results from partnerships are often vague

6.52 All of the active federal-provincial agreements we examined had publicly stated objectives, mostly general statements of intent. The number of agreements has been consolidated from 51 in the early 1990s to 8 today. Consolidating them understandably broadened their objectives. But we expected that each agreement would break down the broad objectives into clear, concrete statements of expected results.

6.53 Each agreement is supposed to have an evaluation framework that sets out expected results in clear, concrete terms. However, we found this in only three of the eight federal-provincial agreements. Exhibit 6.5 summarizes our findings.

6.54 The Agency's agreements with CBDCs and regional economic development organizations did have clearly stated objectives because these organizations provide specific services or carry out specific activities. The

Exhibit 6.5 Our assessment of evaluation frameworks for the eight active federal-provincial agreements

[illegible]	[illegible]
Clear, concrete statements of expected results	3
Indicators with no targets	2
General statements of intent	2
No evaluation framework	1

Source: Evaluation frameworks for federal-provincial agreements

CBDCs submit annual plans to support requests for funding. Generally, the plans clearly state the outputs expected (for example, lending activity or numbers of training sessions or consultations) and also specify the expected outcomes (such as number of jobs to be created or maintained).

6.55 Regional economic development organizations submit annual plans and a five-year strategic plan to ACOA. The statements of expected results in these plans vary in quality from region to region. Some organizations set out expected results in clear and concrete terms, while others vaguely state expected outputs. Most other partnership arrangements focus on activities and outputs as the primary measures of expected results.

The outcomes of most partnerships are not measured

6.56 We found little or no collection by ACOA of ongoing performance information on most federal-provincial agreements. Only on the Atlantic Canada Agreement on Tourism is comprehensive performance information regularly collected and reported. Information is collected and reported on activities and some outcomes of the Canada/Newfoundland Agreement on Economic Renewal and the Canada/Atlantic Provinces COOPERATION Agreement on International Business Development. We also found that provincial government Web sites and public reports disclose more information than ACOA does about the activities, projects, and results of the federal-provincial agreements.

6.57 Agreements are evaluated retrospectively near the end of their usual five-year life span. Therefore, only one of the current federal-provincial and Pan-Atlantic agreements has had a formal evaluation.

6.58 We examined a sample of evaluations for agreements predating the current agreements. We found that the evaluations did not demonstrate that the project activities undertaken could be clearly linked to the results claimed for them. We also noted that except for evaluations of the two Pan-Atlantic agreements, the evaluations we reviewed focussed on activities, outputs, and recipients' satisfaction with services rather than on outcomes the agreements had achieved.

Exhibit 6.5 Our assessment of evaluation frameworks for the eight active federal-provincial agreements

Evaluation framework elements	Number (out of eight)
Clear, concrete statements of expected results	3
Indicators with no targets	2
General statements of intent	2
No evaluation framework	1

Source: Evaluation frameworks for federal-provincial agreements

CBDCs submit annual plans to support requests for funding. Generally, the plans clearly state the outputs expected (for example, lending activity or numbers of training sessions or consultations) and also specify the expected outcomes (such as number of jobs to be created or maintained).

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6.59 The CBDCs provide ACOA with extensive information on their activities and results. At 1 April 2001, these organizations had an investment portfolio of $129 million built up over time. In addition, about four percent of ACOA's annual expenditures are contributed to these organizations. The Agency's 1999–2000 *Performance Report* includes as part of its overall employment impact 2,800 jobs that the CBDCs reported they had created or maintained. It also includes about 860 jobs from The Young Entrepreneurs ConneXion—Seed Capital and Counselling Program administered by the CBDCs on behalf of ACOA. Together, these represent 32 percent of all jobs that ACOA reports it created or maintained in 1999–2000. In our view, the contrast between the level of assistance it provided and the level of results it has claimed suggests, when compared with the Business Development Program, that ACOA needs to examine the credibility of these results.

Roles and relationships with partners are sometimes not clear

6.60 We found that the distinction between the Agency's roles and responsibilities and those of its partners is clearer in some agreements than in others. For example, each federal-provincial agreement is administered by a management committee. Operating procedures established by each management committee clearly set out its roles and responsibilities. However, as already noted, management committees have made decisions that are inconsistent with ACOA's strategic priorities.

6.61 ACOA's role was less clear in its relationships with CBDCs and regional economic development organizations. With little formal guidance, ACOA account managers exercised considerable discretion in determining how involved they would be with these entities. However, the Agency's head office recently updated its manual on managing the Community Futures Program, guidance that account managers can use in monitoring these organizations.

6.62 ACOA can adjust the operational funding it provides to the CBDCs but it does not have the power to recover funds provided for investment purposes, unless a CBDC is wound up. At 1 April 2001, 39 of the CBDCs had built up cash balances totalling about $26 million; the total value of the CBDCs' investment portfolio was $129 million. ACOA has recognized that the cash balances were excessive. It has worked with the CBDCs to create, effective 1 April 2001, a pooling mechanism to encourage the use of excess cash for community economic development.

6.63 The regional economic development organizations were created by the provinces and are managed by volunteer boards of directors; ACOA is only one of the players with influence. The extent to which the work of these organizations is co-ordinated with ACOA varies from province to province, from full integration in New Brunswick, with a memorandum of understanding supported by work plans, to informal discussions in Prince Edward Island. A major product of each regional organization is a strategic plan for economic development in its region. However, ACOA did not consider the strategic plan consistently when assessing project proposals in the same region.

6.64 All of the agreements we reviewed had clauses giving ACOA the right to conduct audits of underlying documentation. Payments to partners and progress in meeting project objectives are subject to regular review by ACOA. The federal-provincial agreements also provide for an evaluation near the end of the agreement's life. As already noted, however, most federal-provincial agreements have been evaluated only when they end, and the evaluations have not focussed on the results achieved under the agreements.

6.65 As part of our audit of individual projects, we examined mechanisms for resolving disputes with partners and procedures to deal with non-performance. We found that the Agency had adequate provisions in its letters of offer to deal with these issues.

Partnership arrangements are transparent

6.66 We found that ACOA's partners are open in providing information on the eligibility requirements recipients must meet for funding. In addition, the Canada business service centres have public information on the services provided by each of the partnership arrangements we reviewed.

6.67 ACOA also has the right of access to all relevant documents of the ultimate recipients of its funding.

6.68 The partners report performance information publicly and to ACOA. The Agency incorporates that information, primarily numbers of jobs created and maintained, as part of its own overall results. Each partner also appears to take credit for any jobs created and maintained, and this double counting makes the actual numbers difficult to determine.

Mechanisms exist to protect the public interest

6.69 We found that the formal arrangements with partners included clauses to ensure the presence of appropriate controls over public funds and measures for citizens to complain and obtain redress. The arrangements also had clauses stipulating the codes of conduct and conflict-of-interest guidelines, as required by the Treasury Board. However, we did not assess whether partners have complied with these clauses.

6.70 **Recommendations.** The Agency should establish clear, concrete expectations for non-commercial projects, agreements, and partnerships.

6.71 The Agency should evaluate the cost effectiveness and outcomes of using partnerships and alliances as a means of delivering its programs. It should also review its policy requiring non-commercial projects to become financially self-sustaining within three years.

6.72 The Agency should develop clear guidance on reporting, accountability, transparency, and protecting the public interest for improved management of relationships with partners.

Agency's response. Concur. The Agency will continue to refine its statements of expected outcomes for non-commercial activities, will undertake the suggested analyses, and will review existing guidance with a view to bringing greater clarity and consistency.

Managing commercial projects

Assistance went to eligible projects

6.73 All 40 of the commercial projects in our sample met the terms and conditions for eligibility approved by the Treasury Board, and they all adhered to the Agency's policies and guidelines. All the projects were linked to one or more of the Agency's strategic priorities.

Assessment policies were applied appropriately

6.74 We found that the Agency's policies on assessing applications for commercial projects were appropriate. The quality of the assessments has improved since our last audit in 1995. We looked for evidence that ACOA had adequately considered the following questions:

- Did the project need the Agency's funding?
- Were other sources of funding available and were they considered?
- Was the project likely to be commercially viable?
- Did it offer a probable benefit to the economy of Atlantic Canada?
- Was the proponent assuming an appropriate share of the risk?
- Would the proponent be able to repay the contribution?

6.75 Assessing the need for government assistance is not easy. Often it is difficult for ACOA to determine whether other funding is available or if government funding is needed to gain access to private capital. We found that the Agency relies on the applicant's signed declaration stating that the assistance is needed. We reviewed the project files to assess the need for government funding. In most of the projects in our sample, there was evidence of the need for government support. For example, applicants with a poor financial history or projects that are not secured by tangible assets have difficulty obtaining financing from other sources.

6.76 The likelihood that an economic development project will become commercially viable is an important consideration. It involves assessing financial projections, market analyses, competitive impact, and technical feasibility. It is important because commercially viable projects provide sustained employment, create wealth, and contribute to the tax base. The files we reviewed had reasonable evidence that the projects would be commercially viable.

6.77 One economic benefit of a project would be a net increase in employment or business activity. A project's potential impact on other segments of the Atlantic economy and the presence of an established market that can support it are also factors to assess. The Agency issues sectoral guidelines for account managers to use in assessing potential economic benefits. All of the project files we reviewed contained evidence that the project was likely to generate an economic benefit to Atlantic Canada.

6.78 The Agency requires applicants to make a minimum investment in their own projects. Except for one isolated case, applicants had made the required investment in the projects we reviewed.

6.79 In 1999, ACOA introduced guidelines on managing risk and monitoring projects. These guidelines set out detailed criteria for assessing risk and assigning a category of risk to a project before it is approved—a rating of low, low-medium, medium, medium-high, or high. The rating is being used to determine how much monitoring is necessary.

Making contributions repayable has helped to improve project management

6.80 One of the key aspects of the Business Development Program is its policy that contributions are to be repaid. The policy is based on the principle that businesses receive a contribution to earn profits or to increase their value. The government should receive back its contribution out of these profits or the increase in value.

6.81 From its introduction in 1995 until 31 March 2001, the Business Development Program provided roughly $460 million in repayable contributions; $78 million of this has been repaid and $12 million written off. Exhibit 6.6 shows the history of repayable contributions in the Business Development Program. The repayment period depends on the nature of the project and of the applicant. For a capital project with a commercial applicant, repayment of the contribution begins not later than three years after the project is completed; full repayment is expected within 10 years.

6.82 The Agency does not take security on the assets of an applicant for a repayable contribution. Applicants can thus retain their borrowing capacity for financing from other sources. Nor does the Agency charge interest on contributions that are repaid on schedule, though it may charge interest when repayment is overdue.

6.83 **Risk management.** The introduction of repayable contributions in 1995 had a profound effect on the way the Agency did business. It now had to do the following:

- assess the applicant's ability to repay;
- establish terms of repayment;
- monitor the project;
- amend or reprofile the original repayment terms, if necessary; and
- collect money owed to the Crown.

Exhibit 6.6 History of repayable contributions in the Business Development Program ($ millions)

	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Opening balance	–	15.8	77.0	169.8	267.3	322.3	–
Expended	15.8	62.3	97.5	112.5	84.2	87.9	460.2
Collected	–	(1.1)	(4.7)	(13.2)	(24.0)	(35.5)	(78.5)
Written off	–	–	–	(1.8)	(5.2)	(5.2)	(12.2)
Closing balance	15.8	77.0	169.8	267.3	322.3	369.5	369.5

Source: Atlantic Canada Opportunities Agency

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- monitor the project;
- amend or reprofile the original repayment terms, if necessary; and
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Exhibit 6.6 History of repayable contributions in the Business Development Program ($ millions)

	1995–96	1996–97	1997–98	1998–99	1999–2000	2000–01	Total
Opening balance	–	15.8	77.0	169.8	267.3	322.3	–
Expended	15.8	62.3	97.5	112.5	84.2	87.9	460.2
Collected	–	(1.1)	(4.7)	(13.2)	(24.0)	(35.5)	(78.5)
Written off	–	–	–	(1.8)	(5.2)	(5.2)	(12.2)
Closing balance	15.8	77.0	169.8	267.3	322.3	369.5	369.5

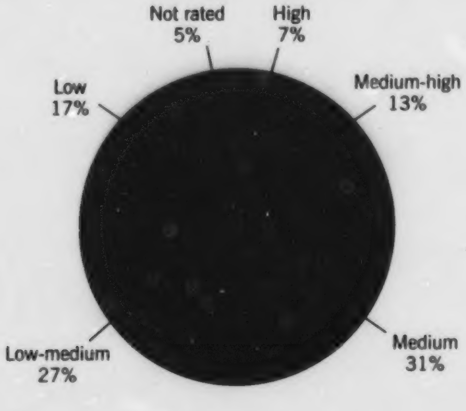
Source: Atlantic Canada Opportunities Agency

6.84 These changes helped to make project approval a more rigorous process than we had found in our 1995 audit. The Agency developed policies, guidelines, and procedures to ensure that repayments were monitored and Treasury Board policies respected.

6.85 Of the contributions in our sample for this audit, 37 were repayable. The Agency had completed risk assessments for all of them. Repayment terms for 36 projects complied with the Treasury Board's transfer payment policy. The repayment period for the other project was one year longer than the policy permits.

6.86 The Agency's rating of project risk allows it to assess the collectable value of its repayable contributions portfolio. The Agency can also analyze the mix of risk to which the portfolio is exposed. The overall risk is reported monthly, both Agency-wide and by region. Exhibit 6.7 shows the mix of assessed risk in the portfolio at 31 March 2001.

Exhibit 6.7 Mix of assessed risk in the repayable contribution portfolio at 31 March 2001



Source: Atlantic Canada Opportunities Agency

6.87 **Collections.** At the end of the 2000–01 fiscal year, the Agency's portfolio of active repayable contributions (principal amounts) totalled $424 million; $281 million of that represented accounts with repayments now scheduled. The first payments on the remaining $143 million are not yet due. In 2000–01, the Agency had budgeted to receive repayments of about $40 million and it received about $48 million.

6.88 The Agency's repayable contributions portfolio includes balances carried over from previous economic development programs in Atlantic Canada. ACOA is responsible for collecting these balances. Exhibit 6.8 shows the active principal outstanding, by program, at 9 July 2001.

Exhibit 6.8 Active principal outstanding in the repayable contribution portfolio at 9 July 2001

[illegible]	[illegible]
Business Development Program	328.9
ACOA Action Program	59.2
COOPERATION agreements	15.9
Atlantic Investment Fund	10.0
Fishery Alternative programs	2.1
Industrial and Regional Development Act	1.1
Borden/Cape Tormentine redevelopment	0.6
Industrial and Regional Development Program	0.4
Economic development component of the Canadian Fisheries Adjustment and Restructuring Initiative	0.4
[illegible]	[illegible]

Source: Atlantic Canada Opportunities Agency

6.89 In addition to the portfolio of active repayable contributions, the Agency has a $60 million portfolio of accounts in substantial arrears owed by insolvent businesses or in other forms of non-compliance. For these accounts, the Agency initiates collection measures, including legal judgments and set-off arrangements with the Canada Customs and Revenue Agency.

6.90 **Reporting.** Neither ACOA's *Report on Plans and Priorities* nor its *Performance Report* gave information on the balances in the repayable contributions portfolio or the amounts collected, written off, and defaulted. Nor has the Agency established performance targets for the portfolio. We would expect it to set targets for collections, accounts defaulted, write-offs, and the mix of risk in the balance of the portfolio.

6.91 **Recommendation.** The Agency should establish targets for, and report publicly on, the performance of its repayable contributions portfolio.

Agency's response. Agree. The Agency will include performance information on the repayable contributions portfolio in the annual *Report on Plans and Priorities*, *Performance Report*, and Financial Statements in this and subsequent fiscal years.

Measuring and reporting performance

6.92 We audited information the Agency reported on 13 key results that it had achieved in 1999–2000 (Exhibit 6.9). We found the following:

- Results reported in its *Performance Report* were linked to expected results in the related *Report on Plans and Priorities*.
- For half of these actual results, expected results had been stated in clear and concrete terms.

Exhibit 6.8 Active principal outstanding in the repayable contribution portfolio at 9 July 2001

Program	($ millions)
Business Development Program	328.9
ACOA Action Program	59.2
COOPERATION agreements	15.9
Atlantic Investment Fund	10.0
Fishery Alternative programs	2.1
Industrial and Regional Development Act	1.1
Borden/Cape Tormentine redevelopment	0.6
Industrial and Regional Development Program	0.4
Economic development component of the Canadian Fisheries Adjustment and Restructuring Initiative	0.4
Total	**418.6**

Source: Atlantic Canada Opportunities Agency

6.89 In addition to the portfolio of active repayable contributions, the Agency has a $62 million portfolio of accounts in substantial arrears owed by insolvent businesses or in other forms of non-compliance. For these accounts, the Agency initiates collection measures, including legal judgments and set-off arrangements with the Canada Customs and Revenue Agency.

6.90 **Reporting.** Neither ACOA's *Report on Plans and Priorities* nor its *Performance Report* gave information on the balances in the repayable contributions portfolio or the amounts collected, written off, and defaulted. Nor has the Agency established performance targets for the portfolio. We would expect it to set targets for collections, accounts defaulted, write-offs, and the mix of risk in the balance of the portfolio.

6.91 **Recommendation.** The Agency should establish targets for, and report publicly on, the performance of its repayable contributions portfolio.

Agency's response. Agree. The Agency will include performance information on the repayable contributions portfolio in the annual *Report on Plans and Priorities*, *Performance Report*, and Financial Statements in this and subsequent fiscal years.

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- For half of these actual results, expected results had been stated in clear and concrete terms.

Exhibit 6.9 The Agency reported on 13 key results in 1999–2000

Key target	Key result
Key commitment 1: Improved growth and competitiveness of Atlantic small and medium-sized enterprises (SMEs)	
Assist 1,000 SMEs to create jobs.	**Target achieved**[1]
Increase the number of students and youth involved in venturing programs to 1,200 per year by 2000–01.	**Target on track**[1] 1,100 youths assisted in 1999–2000.
Assist 750 new businesses and ensuing jobs for young entrepreneurs from 1997 to 2000.	**Target exceeded** Over 900 new businesses assisted.
Create 15 new Canadian Foundation for Innovation projects.	**Target exceeded** Over 20 new projects to support research in universities created.
Achieve a $10 economic return on every $1 spent on Atlantic Canada Tourism Partnership marketing campaign.	**Target almost met** $9.40 economic return achieved for the region.
Assist every year 80 SMEs as successful first-time entrants into the international market.	**Target achieved**
Key commitment 2: Economic opportunities for rural Atlantic Canada through community economic development	
Provide communities with self-development and alternative employment in areas affected by the closure of the Atlantic groundfish fishery.	**Target achieved**[2] Canadian Fisheries Adjustment and Restructuring Program provided the following: • $19.2 million in projects for Newfoundland; • $11.2 million in projects for Nova Scotia. Newfoundland's aquaculture industry increased by 400% from 1995 to 1999—a focus of the Agency's support.
Maintain a high-level of client satisfaction at the Canada business service centres (CBSCs).	**Target achieved** Client satisfaction remains above 87%, despite an 86% increase in the number of enquiries.
Increase access to CBSCs information.	**Target achieved** Presence on Web established. Service delivery partnership with CBDCs created.
Approve 3,000 loans by the CBDCs from 1997 to 2000.	**Target exceeded** 4,050 loans approved.
Key commitment 3: Greater economic activity in Atlantic Canada through national policies sensitive to the needs of the region	
Promote greater understanding of the economic challenges and opportunities facing the region.	**Target achieved** Provided input for the federal government's $700 million Atlantic Investment Partnership.
Build Atlantic business development opportunities into procurement strategies.	**Target achieved** $165 million in industrial and regional benefits.
Co-ordinate economic development activities.[3]	**Target achieved** The Prime Minister, the Minister for International Trade, and the Atlantic premiers participated with over 40 Atlantic exporters in Team Atlantic's 2000 mission to the U.S.

[1] This key result was not supported by reasonable documentary evidence (see paragraph 6.99).
[2] This target was in fact not achieved (see paragraph 6.98).
[3] There was no target for this key result (see paragraph 6.96)

Source: Highlights of the ACOA *Performance Report* for the period ending March 31, 2000 (pamphlet)

Exhibit 6.9 The Agency reported on 13 key results in 1999–2000

[illegible]	
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Assist every year 80 SMEs as successful first-time entrants into the international market.	**Target achieved**
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Source: Highlights of the ACOA *Performance Report* for the period ending March 31, 2000 (pamphlet)

- Eleven of the actual results reported were supported by reasonable evidence.
- The extent to which results are also attributable to other parties is not clear.
- Results claimed were presented in a meaningful, relevant way.

6.93 We audited the accomplishments that ACOA has reported overall for economic development. We found that the overall impact on employment that it attributes to its programs is questionable. It does not take account of the important role played by other economic development organizations in creating and maintaining the same jobs. And the use of a fixed dollar amount to measure jobs created or maintained as a result of assistance to non-commercial projects is questionable.

Performance expectations are usually established

6.94 We found that in the preceding reports on plans and priorities, the Agency had stated in clear and concrete terms its expectations for 6 of the 13 key results it reported in the 1999–2000 *Performance Report*. For example, in the 1999–2000 *Report on Plans and Priorities*, ACOA said it expected to reach specific targets, such as generating a return of $10 per dollar invested in the Atlantic tourism marketing campaign. The basis for these expectations was usually the targets achieved in the past.

6.95 For six other key results it reported, the Agency had stated its expectations in general terms with no targeted numbers. For example, it expected its annual investment in 1,000 small and medium-sized enterprises to result in new employment, business start-ups, sales, and increased productivity. However, it put no figures on any of these expected results.

6.96 One key result cited in the *Performance Report* had no related expectations established in the earlier *Report on Plans and Priorities*.

6.97 ACOA's performance reports cite results in the following areas:

- overall impact on economic development in terms of job growth;
- earned income;
- overall impact on employment; and
- survival rates of ACOA-assisted firms.

However, we noted that the *Report on Plans and Priorities* included no clear, concrete expected results in these areas. Agency officials have informed us that, in their view, it is not possible to target expected results in these areas.

The Agency has reasonable evidence to support most results

6.98 **Measuring results against key results commitments.** The Agency's *Performance Report* includes results for each key results commitment in its *Report on Plans and Priorities*. We examined how ACOA had measured the results it reported (Exhibit 6.9). In one instance, while the result reported was accurate, it was in fact less than the target set by the Agency.

6.99 We found that the Agency had reasonable documentary evidence to support 11 of the 13 results it claimed. It was unable to obtain information from its key delivery partners on the number of students and youth involved in venturing programs. The other result it claimed was that it had helped 1,000 SMEs create jobs. We found that the Agency was basing this claim on the 1,000 projects supported by the Business Development Program rather than the number of enterprises. Only 655 of these projects were carried out by small and medium-sized commercial enterprises. The others were carried out by not-for-profit organizations, educational institutions, or other government organizations. ACOA's data show that under all of its programs in 1999–2000, it supported 713 commercial projects of 657 different clients. For 2001–02, ACOA has reduced its target for SMEs assisted from 1,000 to 800.

6.100 **Benefits Monitoring Tracking System.** The Agency has developed a Benefits Monitoring Tracking System (BMTS). The system should capture key expected results of all large projects and a sample of smaller projects at the time the projects are approved. The information to be entered in the system is tailored to each of the Agency's strategic priorities. The intent is that actual results will be recorded against key expected results. ACOA officials have informed us that the BMTS has been more labour-intensive than originally estimated. Information generated by the system has not yet been used in public reporting.

6.101 **Commercial projects.** The Agency's reported impact on employment as a result of commercial projects is based on the number of jobs that it estimated the projects would create or maintain when it approved them. These estimated impacts are occasionally validated by external studies. September 1998 was the latest review of assumptions and processes used by the Agency in estimating job creation. The Agency also contracts with Statistics Canada each year to survey businesses it has assisted and collect data to support the figures it has reported for employment growth, payroll increases, and survival rates among business start-ups. Other performance information is obtained from internal ACOA systems, client surveys, internal and external studies, and reports from partners.

Measurement of the results of non-commercial projects needs to be re-examined

6.102 **Non-commercial projects.** When measuring the employment impact of non-commercial projects, ACOA assumes that each $25,000 of assistance creates or maintains one full-time-equivalent job for five years. This is based on a study prepared for the 1993 evaluation of the COOPERATION Program, which was updated through reviews in 1997 and 1998.

6.103 We have the following concerns about the use of a fixed dollar amount per job to measure the impact of non-commercial projects:

- Expenditure is a measure of resources used, not a result achieved. This approach will always report better results from higher spending. It is not a direct measure of actual results.

- Employment impact is usually an indirect rather than a direct impact of non-commercial projects. Therefore, the use of jobs created and maintained as a measure of the success of those projects is questionable.
- Finally, there are many variables that would affect any chosen fixed dollar amount per job. Consequently, the accuracy of such results would be questionable.

6.104 An example of the problems with the fixed dollar amount per job is that it is a simple average. However, the non-commercial projects supported by ACOA are not an evenly distributed population. Therefore, use of the $25,000 per job estimate can yield misleading results or hide important characteristics. For 1999–2000, half of the jobs ACOA estimates were created or maintained by non-commercial projects came from only 16 projects, or only four percent of all non-commercial projects under federal-provincial agreements.

6.105 A closer look at these 16 projects illustrates our concerns. For example, the federal government contributed $4.5 million under a federal-provincial agreement to build a new apron and associated taxiway at the Moncton Airport prior to the Francophonie Summit. Using the assumption of one job for each $25,000 of assistance, the impact on employment would be 180 full-time jobs lasting five years. According to ACOA's documentation, however, this project created only 60 jobs that lasted for the 11-month construction phase. In another case, ACOA provided $2.8 million to the Centre for Advanced Research and Development in Global Information Networking. Again, the assumption of one job for each $25,000 of assistance would mean that the Centre would create or maintain 112 full-time jobs lasting five years. ACOA's project documentation shows that the project would create 22 full-time jobs.

6.106 **Community business development corporations (CBDCs).** Of the 11,400 jobs that ACOA's 1999–2000 *Performance Report* estimates it helped create or maintain, 3,666 were associated with CBDCs through their loan portfolios or through the Young Entrepreneurs ConneXion—Seed Capital and Counselling Program, administered by the CBDCs on behalf of the Agency (Exhibit 6.10).

6.107 The reported results are based on quarterly reports from the CBDCs to the Agency. A 1997 study by ACOA concluded that results for 1995 to 1997 were overstated by about 35 percent. In 1998, the Agency surveyed a sample of CBDC clients to again validate the job information they had reported. It concluded that the reports of job creation and maintenance were about 19 percent too low. However, the survey's usable response rate was only 30 percent. The varying results of ACOA's own studies suggest that there is a need for more reliability in the numbers reported as jobs created and maintained by CBDCs.

6.108 We carried out a limited review of the jobs that four CBDCs reported they had created and maintained in 1999–2000. We noted that some CBDC projects also received funding from an ACOA program. The CBDCs and the Agency each reported the same jobs to show their own impact on employment. We identified 46 jobs claimed by the CBDCs and the Agency that were counted more than once. This result cannot be projected to all CBDCs. However, it demonstrates the need for ACOA to carefully review its method of measuring the jobs created and maintained by these organizations.

6.109 The Agency is aware that the CBDCs support many sectors and provide types of financing that ACOA's core programs do not because of policy or regulations—for example, the retail sector, primary fisheries, agriculture, and financing of working capital or cash flow. ACOA does not support these because they yield a limited net economic benefit or are in a sector where overcapacity exists. In fact, ACOA has programs to help individuals adjust out of the fishing industry. Therefore, the community business development corporations support activities that are inconsistent or that even conflict with the Agency's strategic priorities or program policies. However, the Agency includes the results of these activities when it measures and reports its success in meeting its priorities and objectives.

6.110 **Recommendation.** The Agency should develop and implement alternative methods of measuring the impact of its non-commercial projects.

Agency's response. Concur. The Agency recognizes the importance of reliable estimates of economic impact and is pleased to have been recognized previously for its work in this complex field. Nevertheless, we recognize the desirability of continuing to develop innovative and more refined approaches to measuring economic impacts, particularly for non-commercial projects. We will include this effort in our plans for program evaluation and measurement studies.

Reported results are meaningful and relevant

6.111 **Meaningful, relevant and balanced.** ACOA's 1999–2000 *Performance Report* received from the Treasury Board Secretariat and CCAF-FCVI Inc. the Award of Excellence in Public Performance Reporting for small departments and agencies. This award judged the quality of ACOA's reporting in comparison with other departments and agencies of similar size. The accuracy and reliability of the underlying information was not judged. The Treasury Board and CCAF-FCVI Inc. judged that ACOA had reported tangible and significant accomplishments toward its objectives.

6.112 The information in ACOA's *Performance Report* is relevant to its mandate and addresses all of its objectives. It relates most of the reported results to ACOA's activities. However, these accomplishments are usually stated in terms of outputs or activities undertaken by recipients, such as the following:

- number of SMEs assisted;
- number of students and youths involved in venturing programs; and
- number of loans made by the CBDCs.

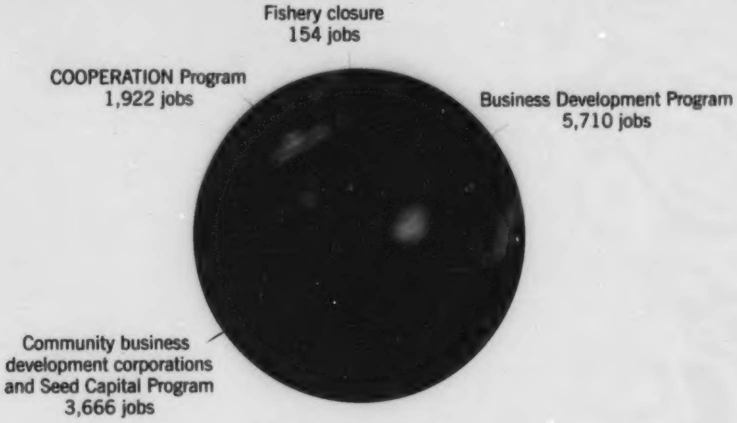
6.113 A major result that ACOA reports, the number of jobs created and maintained, is clearly linked to its mandate. But often it is difficult to relate this result directly to much of the financial assistance ACOA has provided. For example, in 2000–01 about 57 percent of the funding it provided went to non-commercial projects. The Agency has recognized in its own internal studies that these activities are "enabling" projects, usually projects that have a long-term or indirect impact. Therefore, sustainable employment is created only when this infrastructure is used in turn to support commercial activities.

Attribution of results is difficult

6.114 **Attributable.** It is often difficult to attribute an impact to specific government programs or activities. It is particularly difficult for economic development agencies such as ACOA, because economic development involves many players in Atlantic Canada.

6.115 Exhibit 6.10 shows ACOA's figures for jobs created and maintained, by program, in 1999–2000. Overall, since its beginning, ACOA has claimed the impacts on employment shown in Exhibit 6.11. Total employment in the Atlantic region consisted of about 796,000 full-time and 172,000 part-time jobs in March 2000.

Exhibit 6.10 The Agency's figures for jobs created and maintained, by program, in 1999–2000



Total reported jobs created and maintained 11,452

Source: Atlantic Canada Opportunities Agency

Exhibit 6.11 Employment impact reported by the Agency since its beginning

[illegible]	
1987–1993	42,000
1993–94	12,200
1994–95	18,000
1995–96	9,800
1996–97	10,500
1997–98	14,000
1998–99	14,800
1999–2000	11,400

Source: Atlantic Canada Opportunities Agency, *5-Year Report* and performance reports

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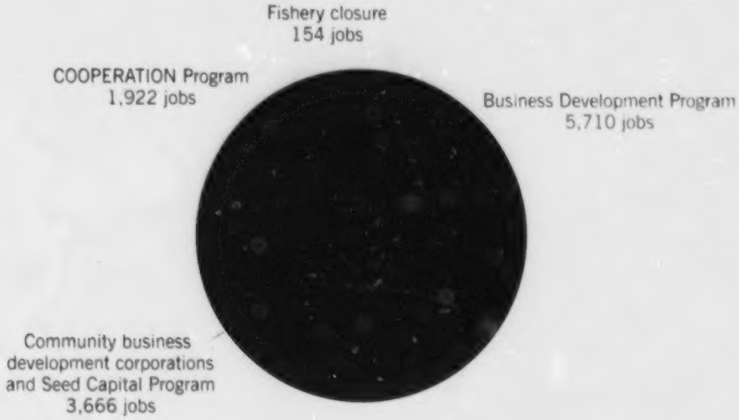

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1995–96	9,800
1996–97	10,500
1997–98	14,000
1998–99	14,800
1999–2000	11,400

Source: Atlantic Canada Opportunities Agency, *5-Year Report* and performance reports

6.116 Provincial governments, regional economic development organizations, other federal departments, and non-government organizations all report having created and maintained jobs in the Atlantic region. ACOA's *Performance Report* includes a brief description of the other partners and players. In our review of projects and ACOA's internal studies, we observed that most ACOA projects are supported by one or more of these other organizations as well. However, the *Performance Report* contains little discussion of their contributions to the results ACOA has reported.

6.117 **Recommendation.** The Agency should report more information on the contribution of others to its reported results.

Agency's response. Agree. The precise attribution of economic impacts to each partner in a joint activity can be challenging, at best. Within our overall calculations, the Agency has consistently included a discount factor that attempts to recognize the economic impact that might have occurred without our involvement. However, we will continue to explore ways to ensure that the contributions of our partners in economic development activities are more precisely measured and reported in departmental performance reports and reports on plans and priorities.

Conclusion

6.118 ACOA's programs are consistent with its mandate, objectives, and priorities. The Agency's framework for controlling grants and contributions is appropriate.

6.119 In reviewing the management of both commercial and non-commercial projects, we found that the Agency exercised adequate control over letters of offer and disbursement of funds, with the following two exceptions:

- considering environmental impacts of projects as an integral part of decision making; and
- including in the letters of offer key provisions that state expected results and protect the government's interests.

6.120 The objectives and expected results of non-commercial projects and federal-provincial agreements are often stated in vague terms. We found that in some instances ACOA's practice was not in keeping with an appropriate framework for governing partnerships. In these cases, ACOA circumvented its own control framework and approved projects. We also found that contrary to its own policy, ACOA was providing long-term core funding to organizations that had little or no prospect of becoming self-sustaining. In the absence of clear, concrete expectations of results for non-commercial projects, it is difficult to determine if the Agency is making progress. The Agency does not have a consistent approach to managing its relationships with partners. It has not evaluated the effectiveness of its use of partnerships and alliances to determine if this is a cost-effective means of fulfilling its mandate.

6.121 We found that the Agency has used due diligence in assessing, approving, and monitoring commercial projects. Its assessment of commercial project applications has become more rigorous since our last audit (Auditor General's 1995 Report, Chapter 18). The Agency has developed policies both to assess the project proponents' ability to repay their contributions and subsequently to monitor their repayment. However, it has not publicly reported on its management of its $400 million repayable contributions portfolio.

6.122 The accuracy and relevance of the employment impact reported for non-commercial projects is questionable. Other performance information is linked well to previously stated expectations and is generally supported by reasonable evidence.

About the Audit

Objectives

The objectives of this audit were to assess the following:

- the extent to which the Agency's programs adequately reflect its mandate, objectives, and priorities;
- the adequacy of the design and implementation of the Agency's control framework for its economic development programs, and its compliance with key authorities such as the *Financial Administration Act*, the *Atlantic Canada Opportunities Agency Act*, the *Canadian Environmental Assessment Act*, and Treasury Board policies and guidelines; and
- the extent to which the Agency's reported results are relevant, accurate, balanced, meaningful, and attributable to Agency activities.

Scope and approach

Our audit focussed on the Agency's core economic development programs for the period 1 April 1999 to 31 March 2001. In particular, we focussed on the Business Development Program, federal-provincial agreements, the Community Futures Program, and the economic development component of the Canadian Fisheries Adjustment and Restructuring Initiative. These programs encompass substantially all of the assistance approved by the Agency during this period.

We examined a sample of projects to ensure that the Agency's activities reflected the government's commitment to the environment and sustainable development and that it has exercised due diligence in managing program delivery. As part of reviewing this sample, we also reviewed the logical links among the Agency's mandate, objectives, priorities, expected and reported results, and program delivery. The audit examined the reliability of selected data underlying reported performance information. We reviewed the Agency's management of its portfolio of repayable contributions to ensure that the Crown's assets are safeguarded, controlled, and properly recorded and reported. As part of our audit we examined the Agency's management of partnerships and alliances.

We did not examine ACOA's participation in the Infrastructure Canada Program or the various adjustment initiatives administered by ACOA to address specific issues such as The Atlantic Groundfish Strategy or Canadian Forces base closures; no assistance was approved under those programs during the period we examined. Nor did we examine the policy, advocacy, and co-ordination activities of the Agency; we focussed on the economic development programs that provide transfer payments.

Criteria

We had the following expectations:

- The Agency would have established clear and measurable objectives, and strategies consistent with achieving opportunities for economic development in Atlantic Canada.
- The Agency's programs would adequately reflect its mandate, objectives, and priorities.
- The projects approved for funding by the Agency would be consistent with its mandate, objectives, and priorities.
- The Agency's management control framework would support the exercise of due diligence in the management of its grant and contribution programs through direct delivery, partnerships, and third-party delivery arrangements.
- The Agency's implementation of economic development would reflect a commitment to the environment and sustainable development.
- The Agency's repayable contributions portfolio would be managed to achieve the economic development objective while ensuring that moneys payable to the Crown were properly collected.

- The Agency's performance information would report tangible and significant accomplishments against objectives, tell a clear performance story, demonstrate the contribution of activities, adequately reflect the facts, and reflect a balanced view of the facts.
- The delivery of economic development activities through partnership arrangements would be co-ordinated and would minimize duplication of effort.

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Report of the Auditor General of Canada to the House of Commons—2001

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Managing the Risks of Non-Compliance
for Commercial Shipments Entering Canada

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

7

Canada Customs and Revenue Agency

International Tax Administration: Non-Residents Subject to Canadian Income Tax

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Canada Customs and Revenue Agency

International Tax Administration: Non-Residents Subject to Canadian Income Tax

Main Points

7.1 The Canada Customs and Revenue Agency reports that in 2000–01 about $3 billion in tax was paid by over 1.7 million non-residents who earn income from Canadian employment, contract services, investments, pensions, and other sources taxable in Canada. The Agency's non-resident enforcement activities have added an additional $350 million in tax.

7.2 The Agency provides a range of services to help non-residents meet their income tax obligations: responding to inquiries; issuing waivers, which reduce the tax withheld on payments to non-residents; and establishing three film industry services units to better service the film and television industry. It also plans to increase its on-line services.

7.3 Many divisions of the Compliance Programs Branch carry out activities to verify compliance with the non-resident tax regime, but they are not guided by a formal risk assessment or a comprehensive compliance strategy to address non-resident tax risk.

7.4 There are gaps in non-resident enforcement: verification of capital gains tax owed by emigrants is inadequate, and high-income non-residents have not been required to file tax returns and pay all taxes owing.

7.5 When reviewing the tax consequences of the sale of Canadian property by non-residents, the Agency has improved its challenging of complex transactions undertaken by non-resident corporations to reorganize their Canadian assets and has identified additional current and future taxes.

Background and other observations

7.6 In some respects, electronic capture and matching programs and automatic compliance routines for non-resident data lag behind domestic tax data.

7.7 The Canada–Barbados Income Tax Agreement is providing opportunities for aggressive tax planning that challenge the Agency's enforcement capability and may cause significant unintended reductions to the tax base.

The Agency has responded. The Canada Customs and Revenue Agency's responses to our recommendations are included in the chapter. The Agency agrees with the 10 recommendations, and its responses describe a number of actions under way to deal with them.

Introduction

7.8 Each year, in addition to processing tax returns from over 20 million Canadian residents—individuals, corporations, and trusts—the Canada Customs and Revenue Agency processes the withholding tax and tax returns of over 1.7 million non-residents who have earned income from Canada. Canadian residents must include their worldwide income in their tax calculations. Foreign income reporting by Canadians and taxing non-residents on their Canadian-source income are the two sides of international tax.

7.9 Non-residents pay Canadian income tax on the income earned in Canada from the following sources:

- employment;
- providing services or carrying on business in Canada;
- investment income such as interest and dividends;
- pensions, royalties, and rent; and
- selling certain types of property, such as real estate or shares of a private corporation.

7.10 Under various sections of the *Income Tax Act*, people who pay such income to non-residents are legally obliged to withhold on account of taxes, and non-residents may be obliged to file a tax return. The Act and bilateral treaties between Canada and other countries define how much tax the payers of income must withhold. In certain circumstances, the withholding tax may be reduced or eliminated with the Agency's approval.

7.11 The Agency's responsibilities for taxation of non-residents go beyond processing and auditing non-resident tax returns. They include ensuring that Canadian payers of income to non-residents understand and comply with their obligations. In 2000, over 1.7 million non-residents received more than $42 billion in income such as interest, dividends, pensions, and royalties from Canada. Most non-residents are not obligated to file a return since the payer is required to withhold the appropriate tax.

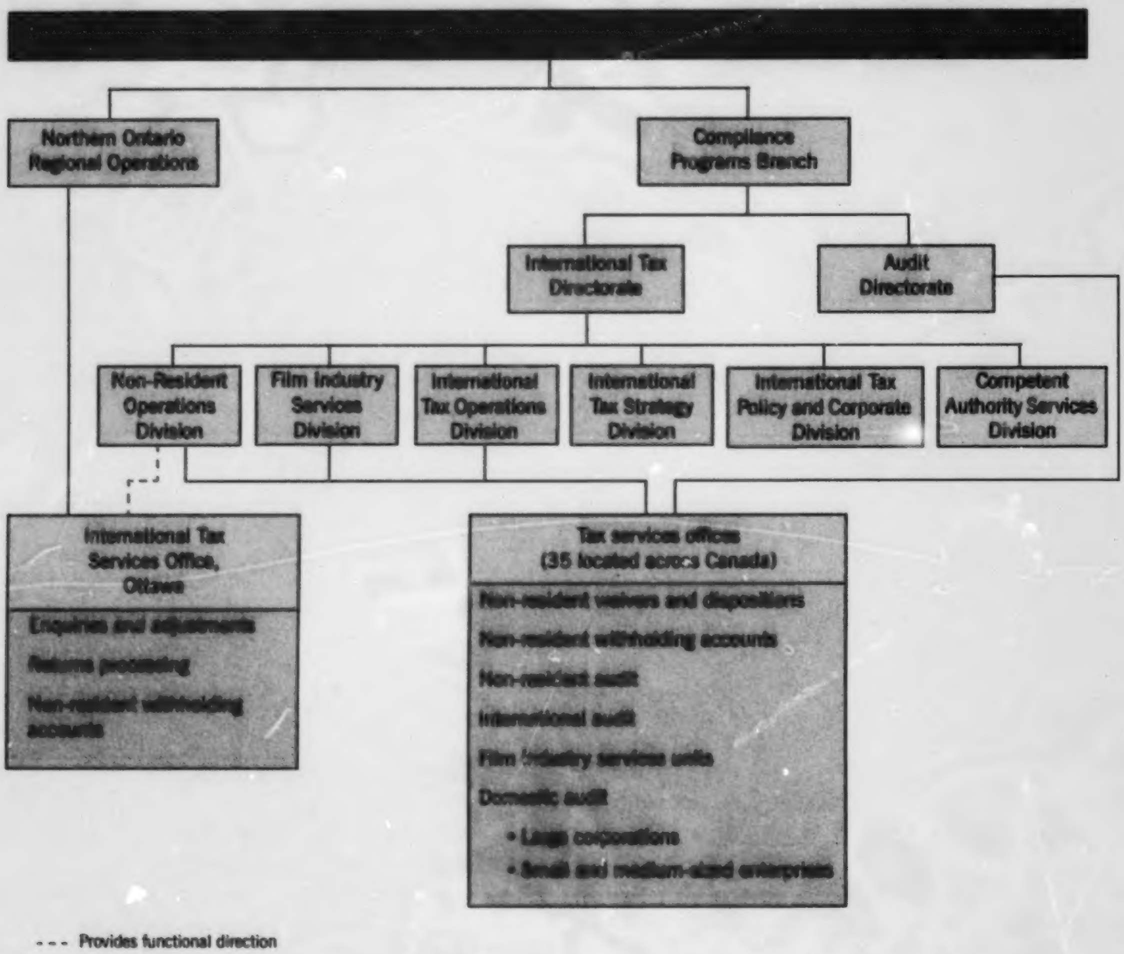
Non-resident tax administration employs several parts of the Compliance Programs Branch

7.12 Several divisions in the Agency provide services to non-residents and ensure that they comply with the non-resident tax provisions (Exhibit 7.1). Within the Compliance Programs Branch, the International Tax Directorate develops and defines tax administration programs and systems to ensure compliance with the legislation and treaties that apply to non-residents and international transactions. It also provides the tax services offices with guidance and technical assistance on non-resident and international tax issues.

7.13 Within the Directorate, the Non-Resident Operations Division and the Film Industry Services Division are responsible for administering the taxation of non-residents. These divisions have staff in Ottawa and in the tax services offices across Canada. The International Tax Strategy Division, located in Ottawa, is responsible for specific compliance research in the international tax area, including non-resident issues.

7.14 The International Tax Services Office, which reports to the Northern Ontario Region and is located in Ottawa, provides assistance and information to non-residents who receive Canadian income and to those that pay investment, pension, royalties, and other such income. It also processes non-resident, emigrant, and immigrant tax returns and non-resident taxpayer requests for adjustments.

Exhibit 7.1 Organization of non-resident compliance activities


Northern Ontario Regional Operations
Compliance Programs Branch
International Tax Directorate
Audit Directorate
Non-Resident Operations Division
Film Industry Services Division
International Tax Operations Division
International Tax Strategy Division
International Tax Policy and Corporate Division
Competent Authority Services Division
International Tax Services Office, Ottawa
Enquiries and adjustments
Returns processing
Non-resident withholding accounts
Tax services offices (35 located across Canada)
Non-resident waivers and dispositions
Non-resident withholding accounts
Non-resident audit
International audit
Film industry services units
Domestic audit
• Large corporations
• Small and medium-sized enterprises
--- Provides functional direction

7.15 The International Tax Directorate has 180 staff; 37 work directly in its Non-Resident Operations Division in Ottawa. The International Tax Services Office has 370 staff; the tax services offices across Canada have 395 international staff, 134 of them dedicated to non-resident work. In each of the six regions there is an international tax advisor who is partly dedicated to non-resident issues.

7.16 There are other groups working on non-resident tax administration. In tax services offices, about 20 international auditors assist non-resident program officers on complex non-resident matters. These matters could include determining whether a non-resident has a permanent establishment in Canada, or reviewing complicated dispositions of taxable Canadian property before establishing the tax payment required from the non-resident.

7.17 Some large tax services offices have been allocated resources over the past two years to review the activities of foreign trusts that do business in Canada or that have acquired significant Canadian assets.

7.18 Within the domestic audit side of the Compliance Programs Branch, auditors of small and medium-sized Canadian businesses are expected to audit certain non-resident and international tax matters along with other tax issues. They also audit, in collaboration with international auditors, similar-sized non-resident corporations doing business in Canada. Agency managers auditing large Canadian corporations are expected to plan and incorporate non-resident withholding issues in their audits; however, the non-resident audit team carries out the audit of the non-resident issues.

Focus of the audit

7.19 This chapter examines the non-resident aspect of international tax administration. In a later Report we will look at activities that verify compliance with the foreign income reporting obligations of Canadian residents and immigrants.

7.20 The objective of the audit was to determine whether rules and procedures are sufficient to secure an effective check on the assessment of tax revenues from Canadian income of non-residents.

7.21 Our audit focussed on several questions: Does the Agency have a risk assessment and a compliance strategy to manage the risks to non-resident taxation? How effectively has it carried out its compliance activities? How appropriately has it reported its performance data? How well does its functional guidance and assistance support the operational activities of its tax services offices? Further information about the audit objective, scope, approach, and criteria can be found at the end of the chapter in About the Audit.

Observations and Recommendations

Facilitation activities

The Agency provides many services to help non-residents meet their tax obligations

7.22 The Canada Customs and Revenue Agency provides many services, such as answering inquiries from non-residents and the payers of non-resident income and providing opinions on residency to those contemplating emigration. The Agency's international and non-resident Web pages (www.ccra-adrc.gc.ca/tax/nonresidents) provide information to non-residents on a variety of tax-related topics. The Agency also administers the waiver program, which authorizes payers to reduce or eliminate the amount of tax withheld on payments to non-residents as a result of a treaty provision or administrative policy. In 2000–01, the Agency waived over $170 million in tax on income earned by non-residents for services in Canada. Recently the Agency established a Film Industry Services Unit in three of its tax services offices to better serve the film and television industry.

7.23 In administering the non-resident tax regime, the Agency undertook the following services in 2000–01:

- Processed over 250,000 telephone inquiries and 117,500 written inquiries from Canada and abroad. Inquiries ranged from requests for information to account adjustments.
- Maintained over 2,400 accounts for payers who withheld $230 million in taxes on payments of $1.7 billion to 29,000 non-residents who performed services in Canada.
- Maintained 80,000 accounts for payers who withheld $2.3 billion in taxes on interest, dividend, pension, royalty, and other passive income payments of $42 billion to 1.7 million non-residents.
- Issued 15,000 waivers.
- Processed 62,000 requests to reduce taxes on pension and rental income, about 37,000 for pension and similar income and 25,000 for rental income.
- Processed about 23,000 determinations of amounts to be paid on account of taxes by non-residents disposing of certain types of Canadian property, and collected $607 million in taxes.
- Processed 300,000 non-resident, immigrant, emigrant, and part-year resident tax returns; 4,500 non-resident corporate tax returns; and 1,000 non-resident trust tax returns.

7.24 The Agency has had plans for several years to enhance certain services, but progress has been slow. Currently the International Tax Directorate is requesting funds to evaluate, plan, and develop services for non-resident taxpayers and the Canadian payers of their income. New on-line services would include general inquiries, filing of tax returns, account maintenance and adjustment requests, and residency determination. This initiative shows the importance the Directorate places on services to help non-residents meet their tax obligations.

7.25 **Recommendation.** **The Canada Customs and Revenue Agency should implement its plans to improve assistance to non-resident taxpayers and their Canadian income payers in meeting their tax obligations.**

Agency's response. The Canada Customs and Revenue Agency (CCRA) agrees with the recommendation. The Agency, in line with the Government On-Line strategy, recognizes the importance of these enhancements to electronic services. As such, this is an initiative that covers all areas within the CCRA, and the International Tax Directorate will continue to work with those other areas to improve its assistance to non-resident clients and Canadian payers.

Risk assessment

Assessing non-resident tax risk is essential to the development of a compliance strategy

7.26 For the past two years, the International Tax Strategy Division of the International Tax Directorate has been responsible for the following:

- researching compliance in international tax;
- developing a strategy to manage taxpayer compliance in international tax; and
- assessing risks using models developed by the Agency's Compliance Research and Quality Assurance Directorate.

7.27 To date, the international tax compliance strategy has not assessed the overall tax at risk related to non-resident taxpayers as a group. Nor has it finished identifying the complexities of transactions and the non-compliance risks unique to Canadian income payers and non-residents who receive various types of Canadian income.

7.28 Many difficulties exist in identifying how non-residents and their Canadian payers fail to comply with tax requirements and in estimating the lost tax revenue. In some cases, the Agency has not collected the data required to do this work; in other cases, the data are not readily accessible.

7.29 Several areas of the Compliance Programs Branch carry out non-resident compliance activities (Exhibit 7.1). For example, international or domestic auditors audit non-resident corporations, while non-resident auditors audit non-resident individuals and Canadian income payers. International auditors also assist in reviewing the complex files on the disposition of taxable Canadian property. As well, the International Tax Services Office (ITSO) plays an essential role in assisting with non-resident tax compliance when reviewing taxpayer returns and adjustment requests.

7.30 The current international tax compliance strategy does not recognize the interrelated nature of the non-resident tax compliance functions undertaken in the tax services offices and the ITSO. For the waiver, election, and disposition certificate systems to function smoothly and provide efficient checks, the ITSO and the tax services offices must co-ordinate their activities. Taxpayer data and compliance activities must be well integrated, and management decisions must be based on the interrelated nature of managing non-resident tax risk.

Communication is important among the groups involved in verifying compliance with the withholding obligations of payers

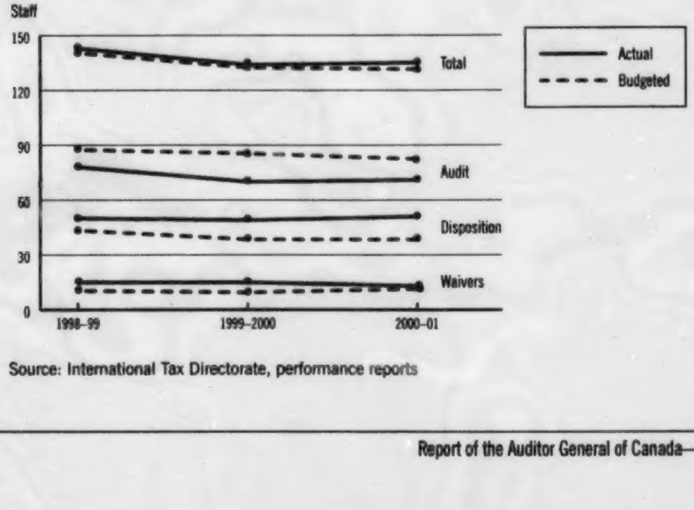
7.31 We observed that the workplan for verifying payers' compliance with their withholding obligations is not carried out as planned in the tax services offices we visited. According to the workplan, non-resident auditors are responsible for the non-resident part of all large corporation audits. However, we noted that they are not participating in all large corporation audits. Instead, the work is often carried out by international auditors. In addition, non-resident auditors are to respond to all requests for assistance from auditors of small and medium-sized enterprises, but there are few requests for assistance from domestic auditors.

7.32 According to the audit performance data from several large tax services offices, few small and medium-sized Canadian businesses have been reassessed for failure to withhold on account of tax on income payments made to non-residents. Our interviews indicated that few of the businesses have been selected by domestic auditors for an audit of payments to non-residents. We are concerned that some domestic audit groups are not sufficiently aware of non-resident tax issues.

7.33 More communication between the non-resident and the domestic audit groups and better awareness of non-resident issues among domestic audit groups could improve the management of non-resident tax risk. In one large office, we observed an example of communication between audit groups. Managers from both groups jointly scanned tax return information—looking for tax risk in payments made by Canadian corporations to their foreign parents or affiliates—and selected files for audit.

7.34 Data for the past three years show that some non-resident staff budgeted for audit activities were used instead to provide important services to non-resident taxpayers (Exhibit 7.2). We are concerned that this has left a gap in the planned non-resident audit activities.

Exhibit 7.2 Non-resident staff in audit, disposition, and waiver activities



Source: International Tax Directorate, performance reports

7.35 The special nature of non-resident taxes and the way the Agency currently structures its compliance activities heighten the need for risk assessment and an integrated strategy for maintaining non-resident tax compliance. Without knowing where tax is at risk, how much is involved, and how the compliance resources assigned actually detect and address non-compliance, we are concerned that the Agency's activities and staff dedicated to non-resident compliance may not be organized and deployed in the most effective way.

7.36 **Recommendation.** The Canada Customs and Revenue Agency should fully assess the tax risk in all areas of non-resident activities and develop an integrated strategy to manage these risks.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation. Work on establishing a tax risk assessment framework for international tax issues is under way but is not yet fully integrated with the existing International Tax Compliance Strategy.

The International Tax Compliance Strategy was introduced in May 2000 and mirrors the broader CCRA compliance strategy. Its basis is a fully integrated risk assessment process designed to develop ongoing and verifiable risk assessment criteria that direct compliance actions in all areas of international taxation. Consideration of the non-resident tax regime is an integral part of this strategy.

The Agency has already analyzed and identified major compliance risks in the non-resident area. For example, we have undertaken risk analyses on Part XIII payments and tax (Withholding Tax on Income from Canada of Non-Resident Persons) with a view to ascertaining the type and size of payments involved, the amounts of taxes withheld, the completeness and quality of the reported data, as well as the extent of potential related compliance issues.

Other information filed by resident taxpayers will be used to analyze and assess compliance in the non-resident program. In this regard, the CCRA will be using the T106 reporting form (Information Return of Non-Arm's Length Transactions with Non-Residents) to develop risk-assessment criteria in the non-resident program.

This form contains valuable information regarding interest and royalty payments to non-residents.

Furthermore, a task force on International Tax Programs was created in April 2001 to review the workload in the tax services offices, the appropriate organizational structure to address the workload, and the personnel required to do it. The goal is to provide for an integrated workflow that maximizes efficiency and effectiveness.

Also, while enforcement activities relating to non-resident withholding tax compliance are carried out by non-resident program staff in the tax services offices, the International Tax Directorate continues to enhance its communications with other audit programs in order to ensure that there is a broader understanding of non-resident issues throughout the Agency organization. In this regard, the International Tax Directorate is presently reviewing the relationship of the small and medium-sized enterprise audit to international audit. The results from this review will dictate what action may be taken to improve on such relationships.

The Agency's performance reporting does not produce complete information on the results of its non-resident compliance activities

7.37 The International Tax Directorate's performance report, prepared for use within the Agency, provides information on the following:

- statistics on resources used and results achieved in various areas of non-resident operations;
- results of audits undertaken by non-resident auditors;
- number of calls, letters, and enforcement actions handled by non-resident account maintenance officers;
- number of waivers and certificates of disposition issued and the amount of tax collected and protected.

7.38 However, the report fails to include the following as part of the non-resident results:

- reassessments by domestic auditors of large corporations and small and medium-sized enterprises that fail to withhold on account of taxes on payments to non-residents for services performed in Canada;
- additional tax reassessed by international auditors of non-resident individuals, corporations, and trusts; and
- adjustments made by auditors to taxes owed by non-residents after reviewing complex dispositions of capital property.

These results are reported under other program activities.

7.39 The report provides information on the total tax paid by non-residents when disposing of property held in Canada. It does not identify separately the additional tax reassessed by the International Tax Directorate when it undertakes the compliance review of the disposition, which generally accounts for a small portion of the total tax. By reporting the total tax collected, the results of the compliance activity are not clearly identified.

7.40 The report focusses on the tax revenue that was protected when applications for waivers by non-residents were denied by the Agency. We believe that providing waivers is a service to non-residents and the total value of taxes waived could be reported as a service provided by the Agency.

7.41 More accurate reports on the amounts and sources of non-resident taxes reassessed by auditors in each of the Agency's audit programs could contribute valuable information for assessing non-resident taxes at risk. The current management information system could be used to produce better reports.

7.42 **Recommendation.** The Canada Customs and Revenue Agency should collect performance data for all non-resident activities in a way that enables it to identify tax risk and produce a comprehensive risk assessment for non-resident taxation.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation and will continue to examine ways, within available resources, to enhance complete and accurate reporting of non-resident activities on a global basis, in an effort to assist in the identification of tax at risk and the continued development of a comprehensive risk assessment for non-resident taxation.

Compliance activities

The Agency is not routinely checking emigrant tax returns for compliance with the obligation to report capital gains

7.43 Each year over 35,000 Canadians emigrate, and the tax returns for their final year as residents are processed by the International Tax Services Office. Before assessing an emigrant's tax return, the Office carries out several initial checks on the return to verify personal exemptions, moving expenses, and claims for refundable tax credits such as the goods and services tax and child tax credits. If the checks indicate non-compliance, the tax return is selected for a review of the credits claimed.

7.44 As part of a long-standing feature of emigration, taxpayers are considered to have disposed of their shares of publicly traded corporations at current market value when they leave Canada. The taxpayer must report the unrealized capital gain on these shares and pay the tax. When the Agency processes the tax return, it does not undertake an initial check for compliance in reporting the unrealized capital gain and paying the tax. If the final tax return were matched against previous tax returns that indicate dividend income or capital gains and losses, the Agency could detect non-compliance and forward the tax return for review.

7.45 In 1996, legislation was announced to broaden the type of capital property an emigrant is considered to have disposed of and to specify the format for reporting these types of capital property. It also permitted emigrants to provide security to the Agency instead of a tax payment. These amendments came into effect in June 2001, retroactive to October 1996.

7.46 With these new migration rules, a greater basket of capital property is considered disposed of on emigration. This makes it even more important that the Agency establish a screening mechanism to identify compliance problems in the reporting of unrealized capital gains by emigrants on their last tax return as Canadian residents.

7.47 **Recommendation.** The Canada Customs and Revenue Agency should introduce a screening mechanism to identify taxpayers' compliance with the obligation to report capital gains when they become non-residents.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation. The CCRA will continue to take steps to ensure that this screening mechanism is included in the processing systems under development for the taxpayer migration rules.

Difficulties in determining whether a non-resident has a permanent establishment in Canada

7.48 An important condition of the non-resident tax regime is whether a non-resident carrying on business in Canada has a permanent establishment or fixed base in Canada. If there is no permanent establishment or fixed base, a bilateral tax treaty may exempt from Canadian tax all the income earned from a service. In such a case, the Agency would issue a waiver, and no tax would be withheld from the payments to the non-resident. If a waiver were not requested initially and taxes were withheld, the non-resident individual or corporation could request a refund by filing a tax return and appropriate documentation with the International Tax Services Office. The Office processes about 1,200 refund requests from non-resident corporations each year; about 20 percent of these are based on the claim of no permanent establishment in Canada.

7.49 International tax auditors who assist non-resident program officers in the local tax services offices determine whether a permanent establishment exists. Over 200 determinations are made across Canada each year. If a non-resident has a permanent establishment in Canada, the Canadian net income is taxed at Canadian rates.

7.50 In 2000 a non-resident successfully challenged in court the Agency's way of determining whether a permanent establishment exists for non-resident professional service providers. The court decided that there was no permanent establishment because the non-resident did not have control of the space where he was providing a training service at the Canadian payer's premises. The International Tax Directorate issued a communiqué in March 2001 explaining that it will apply the court decision on a case-by-case review of the facts.

7.51 The Agency estimated that, at the time the case was decided, there were 46 similar cases with $262 million of gross Canadian revenue that required a determination of permanent establishment status. Each month, additional cases with similar facts are referred for a determination as a result of non-resident requests for refunds.

7.52 We reviewed recent files on permanent establishment determination in the tax services offices we visited. We are concerned that the Directorate's communiqué has not given auditors sufficiently clear direction on how a determination should be made.

7.53 Many cases are still puzzling the auditors. Some involve non-resident corporations providing specialized services to their Canadian subsidiary corporations on a long-term or repetitive basis.

7.54 Tax services offices urgently need clearer guidance to help them provide consistent opinions on permanent establishment that would be in accordance with the internationally accepted definition provided by the Organization for Economic Co-operation and Development and with Canada's treaty obligations.

7.55 **Recommendation.** The Canada Customs and Revenue Agency should review cases requiring a determination of permanent establishment and develop clearer decision-making criteria for its tax services offices.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation. A permanent establishment determination is based on the particular facts in each situation. Therefore, all permanent establishment determinations must be reviewed on a case-by-case basis. An International Tax Directorate communiqué issued in March 2001 to its tax services offices discusses the factors to be considered in making permanent establishment determinations on facts similar to those in the subject court decision. There are procedures in place at the International Tax Directorate when assistance is required on any international tax issue, including determining whether a permanent establishment exists, and an auditor in a tax services office may request assistance under these procedures.

The International Tax Directorate will also continue to work toward clarifying the principles involved in permanent establishment determinations through correspondence, discussions, and workshops with the auditors in the tax services offices. As well, the International Tax Directorate is preparing a guide for the auditors to assist them in making permanent establishment determinations.

The Agency has strengthened its capability to review complex dispositions of taxable Canadian property in some offices

7.56 Non-residents are required to obtain clearance certificates when they dispose of certain types of Canadian property, including real estate, shares of private corporations, and oil and gas leases. If the seller does not pay tax and obtain the clearance certificate, the purchaser becomes liable for the tax owed. Each year the Agency reviews the clearance applications and issues about 22,000 certificates of disposition (Exhibit 7.3).

Exhibit 7.3 Certificates of disposition

	[illegible]	[illegible]	[illegible]
Certificates issued	22,427	20,961	22,787
		($ millions)	
Value of transactions	52,620	64,000	110,500
Tax identified by audit	10	110	280*
Total tax and security collected	120	300	600

*Includes three cases totalling $215 million.

Source: Canada Customs and Revenue Agency

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Exhibit 7.3 Certificates of disposition

	1999	2000	2001
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		($ millions)	
Value of transactions	52,620	64,000	110,500
Tax identified by audit	10	110	280*
Total tax and security collected	120	300	600

*Includes three cases totalling $215 million.

Source: Canada Customs and Revenue Agency

7.57 For the majority of these certificates that involve residential real estate, the review of the selling price and cost of the property is straightforward. Non-resident program officers carry out the reviews, with the assistance of real estate appraisers when necessary. However, reviewing certificates that involve non-resident corporations reorganizing their Canadian assets—mostly shares of Canadian subsidiary corporations—can be much more complex.

7.58 In several of the more complex files we reviewed, the Agency had discovered transactions that appeared to result in highly structured international tax avoidance. These transactions potentially posed a significant risk to the tax base, particularly in future years.

7.59 In the tax services offices we visited, reviews of complex transactions are carried out by an international tax auditor. One office has an international auditor with a tax avoidance background, and valuations of privately held corporations are sometimes carried out. Care is taken to review these transactions for the tax due on account of the current disposition and for the tax consequences of all related transactions. The requirement to obtain a certificate of disposition provides the Agency with the opportunity, in some cases, to view "real time" international tax planning. We encourage the Agency to fully use that opportunity to review the tax implications of the transactions.

7.60 In the smaller tax services offices, non-resident program officers may not recognize the complexity of a transaction and not refer it for a review, or an international tax auditor may not be available to undertake a review. We are concerned that complex international dispositions may not be reviewed in all offices by people with the appropriate skills.

7.61 **Recommendation.** The Canada Customs and Revenue Agency should ensure that all certificates of disposition involving complex transactions are reviewed by appropriately trained staff for current and future tax compliance.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation and will continue to provide training and learning to all staff directly and indirectly involved with the issuance of certificates. The Agency recognizes the benefits of a well-trained staff, and new training courses and learning tools are being developed to supplement those that currently exist.

An example of this is the International Tax Directorate's development of a tool that simplifies the non-resident certificate of disposition process by providing tax services office staff with access to all relevant taxpayer information, thus ensuring current and future tax compliance for this program. This new mainframe system, called the Non-Resident & Emigrant Dispositions Database, is presently in the testing phase in a number of the tax services offices and is anticipated to be in use on a national basis before the end of this fiscal year.

Electronic capture of non-resident tax data is lagging behind domestic data

7.62 The Agency does not make full use of its non-resident tax data to effectively identify non-compliance with tax withholding, reporting, and filing obligations, or to undertake initial enforcement activity. Several problems exist in these data:

- they are not accessible electronically;
- the different systems used to store the data do not communicate automatically; and
- the data stored in these systems lack a common taxpayer identifier.

7.63 For example, the data produced by Canadian employers showing income earned and taxes withheld are recorded electronically and matched against the income and taxes reported by Canadian resident employees and some consultants on their tax returns. The same data produced for most non-resident consultants are not recorded electronically and cannot be matched against the data reported by non-residents who file a tax return.

7.64 Electronic data capture and matching could detect inaccurate reporting on tax returns and could also automate some non-resident enforcement activities. For example, the data captured on payments made to non-resident service providers or on income and expense waivers could be used to generate requests to file tax returns.

7.65 Non-residents who elect to make tax remittances based on their net rental income instead of their gross rental income must file a tax return. Our review showed that the Agency allowed some non-residents who had not filed tax returns to continue to make instalments for several years based on their net rental income. These net rental income elections could be matched electronically so that a non-resident who applied for a third net election before filing a tax return would automatically be denied. The Agency automatically takes action in cases of Canadians whose income data indicate that a tax return is expected.

7.66 The International Tax Services Office cannot access the database with information on certificates of disposition when it processes the tax return of a non-resident who has disposed of property. If a taxpayer does not attach the certificate to the tax return when requesting a tax adjustment, the Office will often forward the return to the tax services office that issued the certificate to verify that the tax was paid. Access to the database would free non-resident staff in tax services offices from having to validate information manually.

7.67 Generally, electronic data capture and matching of non-resident tax information seem to lag behind domestic tax information. By improving the electronic data capture and matching programs and centralizing some initial enforcement activities in the International Tax Services Office, non-resident staff in the tax services offices would be free to concentrate on other activities. Those activities could include identifying non-residents who owe additional tax or payers who have failed to withhold tax on payments to non-residents and who have not been identified in data already available to the Agency.

7.68 **Recommendation.** The Canada Customs and Revenue Agency should increase its efforts to bring electronic capture and matching programs for non-resident tax data up to the standards of domestic tax data, and streamline simple enforcement activities between the International Tax Services Office and the tax services offices.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation. Presently, the CCRA is pursuing ways to link information stored in our systems in order to enhance our compliance efforts.

To improve our ability to validate information on filed returns, the International Tax Services Office (ITSO) and all tax services offices will have access to the Non-Resident & Emigrant Dispositions Database, containing all information on certificates of disposition. It is now in the testing phase in a number of the tax services offices, with an anticipated national roll-out before the end of this fiscal year. This will allow all tax services offices, including the ITSO, to access all relevant information relating to non-resident dispositions, thus substantially reducing the time necessary to validate information on the filed returns.

Beginning in 2001 we have revised our administrative procedures and information system used to process rental income earned by non-residents of Canada. We can thus verify client data annually and ensure that their filing obligations or payment of their fair share of taxes under Part XIII of the *Income Tax Act* have been met.

The International Tax Directorate is also currently working on bringing all non-resident information return data on-line, such as the reporting of the information relating to services provided in Canada by non-residents.

In addition, efforts have already been made to clearly and meaningfully distinguish between the roles of the ITSO and the other tax services offices with respect to both our compliance and our enforcement programs. For example, in addition to the regular enforcement of non-resident withholding, compliance projects specific to the ITSO have been implemented in that office. These programs are aimed at recovering potential lost tax dollars, and they benefit from the centralized knowledge base and expertise situated in the ITSO. Furthermore, we are in the process of gathering information from our offices nation-wide with respect to their workloads and responsibilities in an effort to continue to work toward providing them with streamlined instructions based on this and related input.

There are some inconsistencies in non-resident tax administration

7.69 One goal of tax administration is consistency. Given any set of facts, a taxpayer should expect the same treatment from all of the tax services offices across Canada. To achieve this, central administration communicates its policies to field offices in a number of ways: manuals and communiqués, training courses, regional conferences, electronic tools, and consultations with technical specialists. However, we noted several inconsistencies among the tax services offices in some operational and reassessment practices.

7.70 For example, the Agency audits the rental income of non-residents when asked to issue a certificate of disposition. The number of years of rental income reassessed varies among tax services offices. Some tax services offices issue the certification of disposition only after completing the tax reassessment for the rental income. Other offices issue the certificate even if the tax reassessment on the rental income is not completed—which diminishes the probability that the unpaid tax on rental income will be collected.

7.71 When finalizing a determination of no permanent establishment, some offices calculate the employee deductions owed in Canada by non-resident corporations before approving a refund, while others do not.

7.72 Tax services offices have differing requirements before an employer can reduce the amount of income tax it withholds from a non-resident employee. One office reassessed an employer who had failed to withhold tax on income paid to a non-resident employee for services provided outside Canada, because the employee had not obtained a waiver from the Agency. In a similar situation, another office took no action against the employer.

7.73 We also observed inconsistencies in the amount of tax that payers were reassessed when auditors found a failure to withhold taxes on payments to non-residents for services. In some cases, the tax was reassessed based on the non-resident's expected final Canadian tax liability. In other cases, the tax was reassessed based on the full amount of the contract payment, even when it was clear that the non-resident would be taxed on a lesser amount. The amounts at stake can be important. In one particular case, the difference between the two approaches could make a difference of tens of millions of dollars. The way penalties and interest charges are applied to these reassessments is also inconsistent.

7.74 **Recommendation.** To achieve consistency, the International Tax Directorate should finalize guidance on outstanding administrative policies and monitor their application by the tax services offices.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation and has been working diligently at finalizing guidance on administrative policies. The International Tax Directorate will continue to develop and/or enhance administrative policies in order to ensure that all clients receive fair, consistent, and equitable treatment under the Canadian income tax system. In this regard, the International Tax Directorate has met with a number of stakeholders, including its International Tax Advisory Committee that consists of recognized experts, to explore areas of concern and will continue its communication efforts with the private sector associations. The International Tax Directorate considers that this continued consultation will provide for administrative policies that are clearer and more relevant to specific industries, which will both strengthen consistency and improve voluntary compliance. The CCRA is also working closely with the Department of Finance in this undertaking to ensure that new administrative rules are consistent with government tax policy.

The International Tax Directorate ensures national consistency and balanced program delivery by providing functional direction, program support, policies and guidelines, technical assistance, and an accountability framework to the tax services offices for all non-resident activities; by monitoring program performance and results; and by participating in quality reviews. The Directorate currently monitors the application of administrative policies in the tax services offices and will continue this practice as new, enhanced policies are introduced.

The Agency has not followed up on some high-income non-residents who did not file tax returns

7.75 In some cases, the Agency has not estimated, identified, or collected the Canadian tax that non-residents may owe beyond the amounts withheld at source for services provided in Canada.

7.76 An International Tax Directorate study revealed that in a particular tax year, fewer than 2 percent of non-resident individuals and fewer than 20 percent of non-resident corporations who receive payments for services in Canada filed a tax return. The study identified a number of individuals who had not filed tax returns and the estimated amount of the unpaid tax. Of 31 non-resident individuals who had each received over $1 million, 29 had not filed a tax return. Twenty were actors who are not entitled to tax exemptions under the applicable tax treaty and whose entire Canadian income is taxable. The potential amount of tax owed for that tax year by these 20 non-residents was estimated by the Agency at $10 million. The Agency took no action on these cases and did not analyze the tax at risk for subsequent taxation years, giving some non-residents what amounts to partial tax forgiveness.

7.77 In June 2001, against this backdrop of non-compliance, legislative changes to the tax regime for non-resident actors in the film and television industry received royal assent. The changes were made to simplify the tax filing requirements for non-resident actors and to reduce the paperburden. Actors now are subject to a final tax of 23 percent of gross income and no longer are required to file tax returns.

7.78 The Agency has created film industry services units in three major tax services offices. In addition to providing better service to the industry when tax waivers are requested, the units will also audit compliance with the provisions of the *Income Tax Act*. Currently the Agency has no specific plans to deal with non-residents who did not file tax returns.

7.79 **Recommendation.** The Canada Customs and Revenue Agency should consistently take action when it identifies non-residents who have not complied with tax filing requirements.

Agency's response. The Canada Customs and Revenue Agency agrees with this recommendation. All non-residents, including non-resident actors, are subject to withholding taxes at source for services provided in Canada. With respect to the situation involving non-resident actors, as noted in this chapter, in order to address non-compliance, the CCRA and the Department of Finance engaged in meaningful consultations with the film industry to ensure a consistent and fair approach to the taxation of individuals within that industry. These discussions led to changes in the compliance regime for this industry and resulted in the establishment of a dedicated film industry function, three film services units in the field, new legislation enacted for the film industry, and industry-specific waiver guidelines.

Also, the study carried out by the CCRA on non-resident compliance resulted in a number of conclusions and recommendations that are actively being pursued by the CCRA and the Department of Finance. These involve policy and procedural changes, system changes, and legislative changes in order to enhance the compliance and enforcement efforts for non-residents.

There is also continuing routine enforcement in relation to all non-resident compliance issues. The CCRA will continue to improve the selection of income tax files to increase the effectiveness of its efforts to achieve compliance with its tax filing requirements for non-residents.

The Agency has reviewed the files of other high-income non-resident employees

7.80 Many high-income non-resident employees are athletes who play for Canadian professional sports teams. As non-resident employees, these individuals file tax returns and claim a Canadian tax exemption on the income earned for services provided outside Canada. To verify their returns, the Agency must determine that they are not Canadian residents and that their total income reported for services in Canada is correct.

7.81 In the 1990s, the Agency started to review the residency status of all non-resident athletes and the income reported on their tax returns. The Agency also worked with Canadian professional sport teams to develop a formula for allocating an athlete's income to services in Canada and services in the U.S. Non-resident athletes can reduce Canadian taxes through bonuses and retirement compensation arrangements, which may be taxed at a lower rate than employment income. The Agency continues to review these arrangements to ensure compliance with the provisions of the *Income Tax Act* and its Regulations.

7.82 Over the last three years, the Agency has also reviewed the tax returns of non-residents working for airlines domiciled in Canada. In certain cases, auditors have challenged the residency status of the taxpayer; in other cases, they have questioned the allocation of income for services provided inside and outside Canada. As a result, the Agency has reassessed the tax returns of over 200 taxpayers, for additional tax of $2.9 million.

Electronic commerce is an emerging issue in non-resident tax administration

7.83 Electronic commerce—businesses offering electronic services or the sale of goods electronically—is an emerging issue in international taxation. It challenges two central concepts of international tax agreements:

- **The character of the income.** For example, payments to non-residents for royalties and for goods and services are taxed at different rates under domestic tax legislation and tax treaties. Electronic commerce often blurs the distinction between payments of royalties and payments for goods and services.

- **Where the income is earned.** Business income is taxed under most tax treaties in the country where the business has a permanent establishment or fixed base. In electronic commerce, the source of business income becomes unimportant.

7.84 The Organisation for Economic Co-operation and Development, through a number of task forces, is developing guidelines for member countries on the taxation of electronic commerce. Canada participates on some of these task forces. The Agency's Tax Avoidance and Special Audits Division (part of the Compliance Programs Branch's Audit Directorate) manages the electronic commerce initiative. It is still to be determined how the audit of businesses with no permanent establishment will proceed worldwide.

The Canada–Barbados Income Tax Agreement is being used to reduce Canadian tax

7.85 During our review of non-resident files, we noted that the Agency has discovered a number of schemes developed to exploit the Canada–Barbados Income Tax Agreement. Canada usually signs tax treaties to avoid double taxation. Barbados does not tax capital gains. However, the Agreement allows a resident of Barbados to claim a Canadian tax exemption on a capital gain that would otherwise be subject to Canadian tax. The Agency is currently reviewing transactions that move capital gains from Canada to Barbados.

7.86 In one scheme, ownership of a private Canadian corporation is held by a trust that resides in Barbados. The capital gain on the sale of the shares is subject to Canadian tax because the shares are taxable Canadian property. The trust sells the shares and claims an exemption from the Canadian tax under the Agreement. The gain is not taxed in Barbados.

7.87 Another scheme, referred to as the offshore spousal trust scheme, shifts an unrealized capital gain from Canada to Barbados. This scheme involves the following series of transactions:

- shares in a Canadian company are sold at tax cost to a trust that resides in Barbados, in favour of the taxpayer's spouse;
- the trust then sells the shares at fair market value back to the individuals who owned them originally; and
- the trust then claims an exemption from Canadian tax under the Canada-Barbados Agreement.

The transactions are intended to increase the tax value of the shares to their current fair market value. If the scheme is successful, any subsequent gain realized from a sale of the shares to an arm's-length third party will be reduced by the artificial increase in the tax value of the shares.

7.88 The Agency has identified 53 examples of this scheme that have moved over $800 million in capital gains to Barbados from Canada. It is currently examining this scheme to determine if it can be challenged successfully.

7.89 In another scheme, a company residing in a tax haven owned a Canadian company. When the shares of the Canadian company were sold, any capital gain realized would be subject to Canadian income tax. The company shifted its residence from the tax haven to Barbados and, under the Agreement, claimed a Canadian tax exemption on the capital gain. During our audit, we saw one transaction that the Agency challenged successfully, recovering over $50 million in tax.

7.90 Tax avoidance schemes may also take advantage of other treaties. A number of years ago, the Agency identified schemes involving other tax treaties to which Canada was signatory. The schemes allowed capital gains to escape Canadian tax under certain conditions. The *Income Tax Conventions Interpretation Act* was subsequently amended to allow Canada to tax the capital gain.

7.91 **Recommendation.** The Canada Customs and Revenue Agency should continue to be vigilant in ensuring that tax treaties are not used inappropriately to reduce Canadian tax and, if necessary, should seek legislative or treaty changes to protect Canada's tax base.

Agency's response. We agree that the Canada Customs and Revenue Agency will continue to be vigilant to ensure that tax treaties are not inappropriately used to reduce Canadian tax. As noted in paragraph 7.90, CCRA officials promptly seek legislative or treaty changes where necessary to protect Canada's tax base.

Conclusion

7.92 Over 1.7 million non-residents receive taxable income from more than 80,000 Canadians. In 2000–01, non-residents paid about $3 billion in taxes on this income. This amount is likely to increase with the growth of multinational corporations, global investment opportunities, and international skilled workers.

7.93 The Agency plans to offer more electronic services to help non-residents meet their tax obligations. However, its non-resident compliance activities are carried out by many divisions of the Compliance Programs Branch. Until a risk assessment is completed and a comprehensive compliance strategy is put in place, we are concerned that the appropriate attention may not be paid to all elements of non-resident compliance. The Agency needs to report the results of all its non-resident compliance activities in order to improve the usefulness of its performance management information and aid in the assessment of risk. The Agency could also make better use of its non-resident taxpayer data to direct non-resident enforcement activities and ensure that they are consistent.

7.94 Using the information provided by non-residents when they dispose of Canadian property, the Agency is able to detect potentially abusive international tax planning by non-resident corporations and trusts active in Canada.

7.95 The growth of electronic commerce will increase the complexity of non-resident taxation. We encourage the Agency to continue its participation in the international forums that will set the guiding principles.

About the Audit

Objective

The objective of the audit was to determine whether rules and procedures are sufficient to secure an effective check on the assessment of tax revenues from Canadian income of non-residents.

Scope and approach

The audit focussed on the following activities of the Agency:

- fostering compliance with the sections of the *Income Tax Act* that require payers of Canadian income to non-residents to withhold and remit tax on that income;
- assisting non-resident taxpayers to obtain waivers or reductions in their taxes; and
- encouraging non-residents, including emigrants, to comply with their obligations to file tax returns and pay the correct amount of tax.

We reviewed the International Tax Directorate's non-resident risk management plan and operations. Our work was conducted in the Directorate's headquarters, in the International Tax Services Office in Ottawa, and in selected tax services offices. We reviewed selected audit files, interviewed Agency management and staff, and analyzed performance data on the results of non-resident compliance activities. We looked at the assistance provided by specialized international auditors in some complex matters involving non-residents and by other domestic audit groups involved in auditing non-residents. We looked at the head office administrative support provided to these activities, and at the strategic advice and direction provided on risk assessment and development of a compliance strategy for non-resident activities. We also discussed non-resident operations and policies with the private sector.

Criteria

Our audit is based on the following criteria:

- The Agency should understand the tax risks associated with non-resident taxation and have a non-resident compliance strategy to manage these risks.
- The Agency should have the capacity to satisfactorily carry out its non-resident compliance activities.
- The International Tax Directorate should provide timely functional guidance and assistance to non-resident operations in the tax services offices.
- The International Tax Directorate should measure and report meaningfully on the results of non-resident compliance activities.

Audit team

Assistant Auditor General: Shahid Minto
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Chapter

8

Canada Customs and Revenue Agency

Managing the Risks of Non-Compliance for Commercial Shipments Entering Canada

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Canada Customs and Revenue Agency
Managing the Risks of Non-Compliance for Commercial Shipments Entering Canada

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Main Points

8.1 The Canada Customs and Revenue Agency (CCRA) needs to improve its enforcement activities for commercial shipments, both how it identifies high-risk shipments and how it analyzes the results of its activities. While it has worked hard over the past decade to improve its enforcement activities, it still faces many challenges. The Agency is using a risk management approach to determine which shipments present the greatest risk to Canadian society so it can focus on those shipments and let the others pass through quickly.

8.2 The Agency has tried to improve its compliance verification activities by implementing a new approach to ensuring that importers are complying with Customs trade laws and regulations. However, after six years and a lot of effort, it has made little headway in assessing how well importers are following the rules. A revised approach is promising but has yet to be proved.

8.3 The CCRA has made it easier for importers to bring legitimate goods into Canada and has provided them with several processing options. Importers who are pre-approved and those who send the required information to the Agency before the shipment arrives at the border experience little delay of their shipments.

Background and other observations

8.4 As a trading nation, the health of Canada's economy depends on imports and exports. In the past eight years, the volume of commercial shipments entering Canada has increased dramatically, from 7 million a year to over 10 million today. The increase in volume is partly because of the North American Free Trade Agreement.

8.5 The objective of the Customs program is to protect Canadian society and promote Canada's competitiveness. Until this year, the Agency has not provided Parliament with enough information to show how well it is achieving these objectives. The new performance report required by the Agency's legislation provides more information, but the Agency still needs to develop detailed performance measures, set expectations, and evaluate actual performance against expectations.

8.6 The Customs Action Plan is the CCRA's plan to change the Customs program in the near future. In our view, it includes many good ideas to help the CCRA achieve its objectives. We are concerned, however, that the Agency is going ahead with the Customs Self Assessment initiative before its compliance verification regime is solidly established.

The Agency has responded. The Agency agrees with our recommendations and in its responses has indicated the actions it will take to address them.

Introduction

8.7 The Customs program is an important part of the Canada Customs and Revenue Agency (CCRA). The Agency's 2000–01 *Report on Plans and Priorities* says the objectives of the Customs program are "to protect Canadian society and promote the competitiveness of Canada through the facilitation of international trade and tourism balanced with responsible border management." Responsible border management means making it easy for legitimate goods and admissible people to enter Canada while keeping out illegal or restricted goods and inadmissible people. Customs officers have to deal with this difficult balancing act every day.

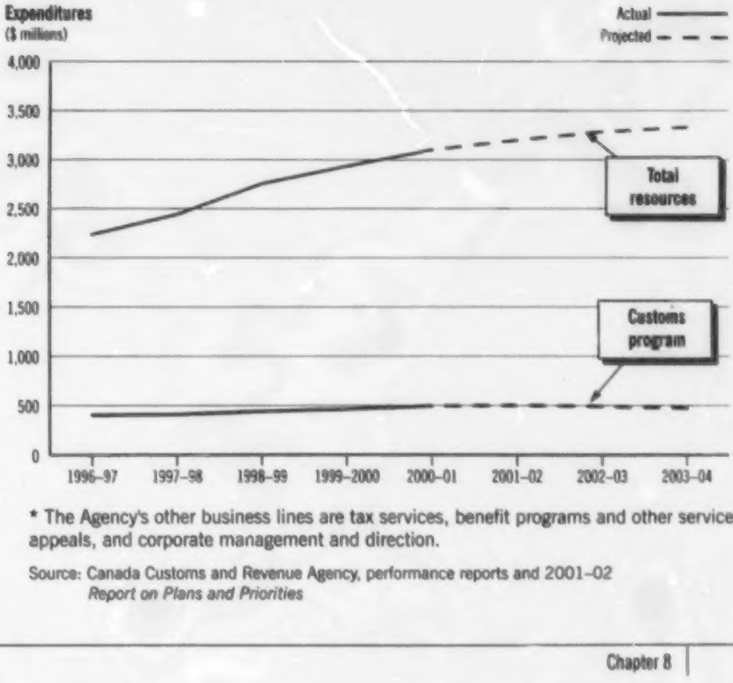
8.8 The CCRA spends about 16 percent of its resources on the Customs program. The other 84 percent is spent on administering its other business lines—tax services, benefit programs and other services, appeals, and corporate management and direction (Exhibit 8.1). About 7,200 employees work in the Customs program.

8.9 The Agency's Assistant Commissioner, Customs is responsible for the following:

- establishing policies for the Customs program;
- developing programs to deliver those policies;
- providing advice on the programs to employees; and
- building strategic relationships with clients and stakeholders.

Six regional assistant commissioners are responsible for delivering the Customs program and all other CCRA programs in their regions.

Exhibit 8.1 The Agency's resources for its Customs program and other business lines*



* The Agency's other business lines are tax services, benefit programs and other services, appeals, and corporate management and direction.

Source: Canada Customs and Revenue Agency, performance reports and 2001–02 *Report on Plans and Priorities*

8.10 Five main statutes govern what CCRA officials do in the Customs program: the *Customs Act*, the *Customs Tariff*, the *Special Import Measures Act*, the *Excise Act*, and the *Excise Tax Act*. The Agency also administers parts of many other laws for other government entities, such as the Canadian Food Inspection Agency, Environment Canada, Health Canada, and Statistics Canada (see the Appendix).

A changing environment

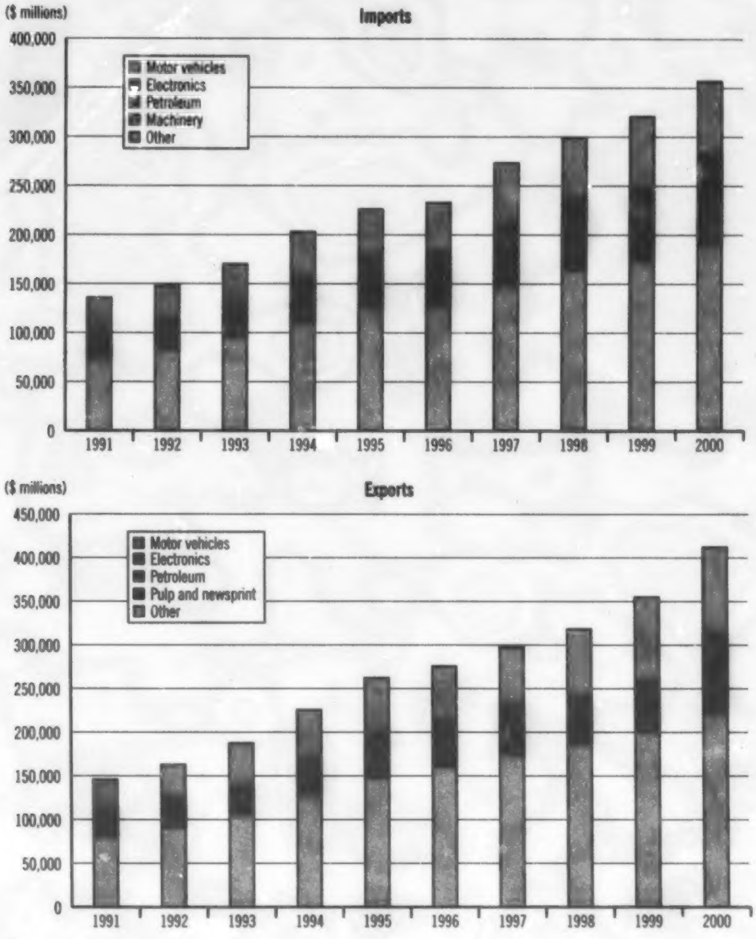
8.11 **Globalization of trade.** Canada is a trading nation, and the health of our economy depends on imports and exports (Exhibit 8.2). In 2000, imports totalled $357 billion and exports $412 billion; exports represent 39 percent of Canada's gross domestic product. Companies have found faster ways to move their goods, increased their capabilities to exchange information, and looked for ways to be more competitive. Canadian governments have worked to make it faster and easier to bring goods into Canada. These trends are likely to continue.

8.12 In the past eight years, the CCRA has faced a dramatic increase in the volume of commercial shipments entering Canada, from 7 million a year to over 10 million today. The increase in volume is partly the result of the free trade agreements Canada has negotiated with its trading partners, and especially the North American Free Trade Agreement. The agreements give Canada greater and more secure access to foreign markets. They have also reduced customs duties or even eliminated them so that the government is collecting less revenue from customs duties, down from over $4.5 billion in 1989–90 to just over $2 billion in 1999–2000. In the next few years, we can anticipate more free trade agreements.

8.13 **Information technology advances.** Changes in technology are also affecting the way the CCRA conducts business. Increasingly, the Agency and many of its clients exchange and process information electronically. The CCRA also uses the Internet to keep its clients up-to-date on the import process. These and other efforts are aimed at increasing productivity for both the CCRA and its clients. The CCRA also uses new technologies in its enforcement activities.

8.14 **Changes to laws.** The laws and regulations that the CCRA administers in the Customs program are continually changing. For example, the definition of pornography has changed over the years through amendments to legislation and by court decisions. The list of endangered species changes as scientists learn about new ones. New threats to Canadians' health can occur at any time, and new regulations are drafted to deal with them. The Agency responds to these changes with written directives and training, where necessary, to keep its employees up-to-date.

Exhibit 8.2 Major Canadian imports and exports in the last 10 years



Source: Statistics Canada

Importing goods into Canada

8.15 There are about 160,000 commercial importers doing business in Canada. Most of them (about 150,000) together account for around 10 percent of the total value of goods imported each year. Of the rest, the thousand largest importers account for about 54 percent of the total import value. This means that the CCRA needs processes to handle both large companies that import thousands of shipments a year and smaller importers of only occasional shipments.

8.16 Many importers need a quick process at the border because they no longer maintain large inventories; a delay in receiving goods could shut down an assembly line. The CCRA thus has to process thousands of transactions rapidly while finding the few that need to be stopped.

8.17 Under the *Customs Act*, importers must present certain information to the CCRA about the goods they are importing. Customs officers review this information and decide whether they want to inspect the shipment. If they don't, the goods are released immediately. If they do, the goods are released after they pass the inspection. Goods cannot enter the Canadian economy unless a Customs officer releases them. This provision is being amended so that when an approved importer receives goods that qualify, they are considered released for customs purposes.

8.18 Most importers and brokers have registered with the CCRA for delayed payment privileges. This means that the CCRA will release their goods on arrival but they must send the Agency a full accounting of the shipment, usually within five days, and pay the duties and taxes by the end of the month. Those who have not registered must account for and pay the duties and taxes before the Agency will release their goods.

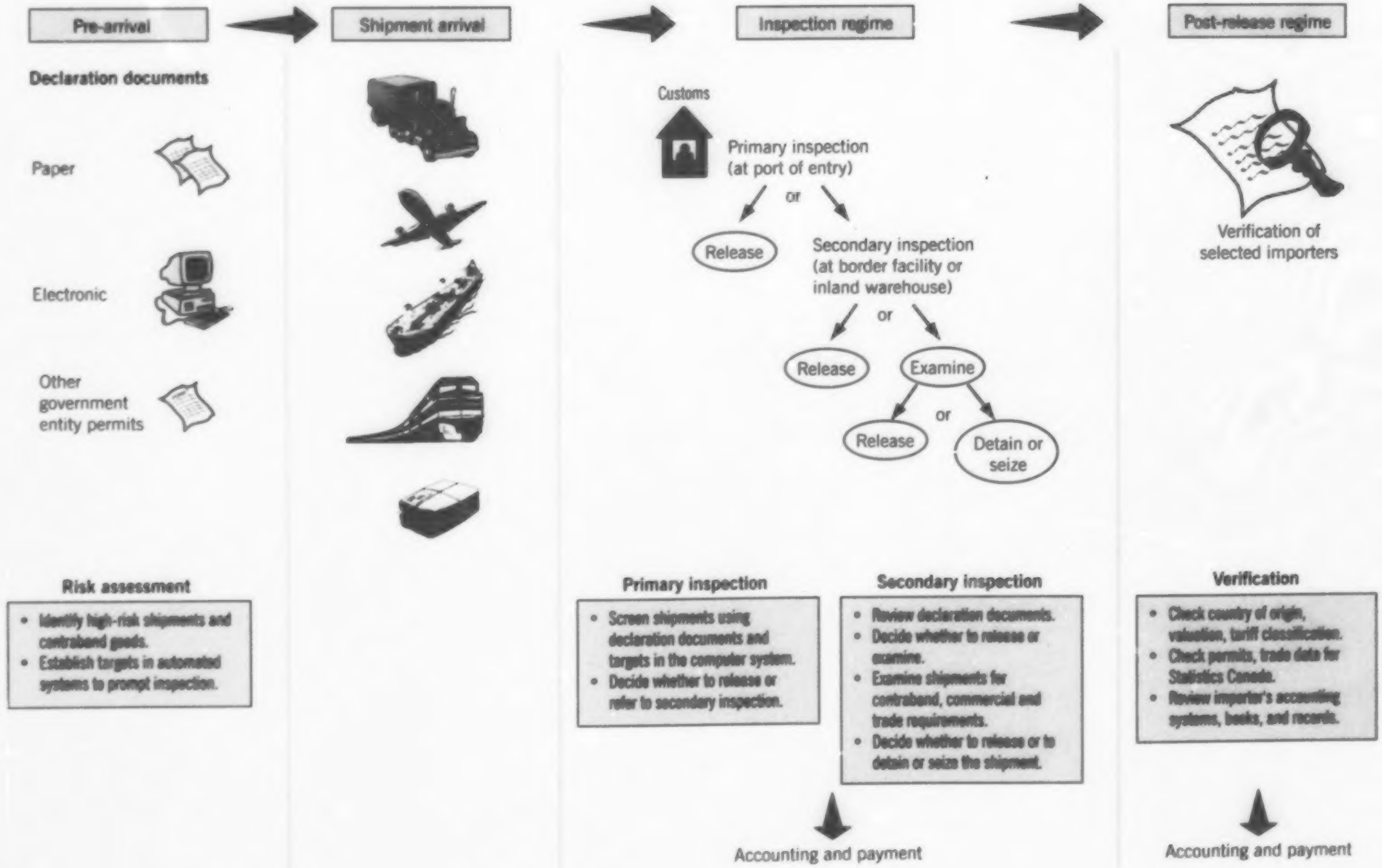
8.19 After releasing the goods, the CCRA checks a sample of importers to verify that they have properly reported the goods and paid all taxes and duties (these checks are "compliance verifications"). Exhibit 8.3 describes the process for importing commercial goods into Canada.

Focus of the audit

8.20 Our audit examined how the Agency manages the risks of non-compliance with Canadian laws and Customs regulations that may exist in commercial shipments entering Canada at legal ports of entry. These include 147 land border crossings between Canada and the United States, 13 major airports, and 3 major seaports. We focussed on how the Agency assesses those risks and how it works to ensure the speedy release of legitimate goods while keeping out illegal goods. We also examined how the Agency makes sure that importers are following the rules. We last audited this area of its operations in 1994. At that time, we focussed on the assessment of customs duties. In 2000, we examined the way the CCRA manages the risks that travellers present; we reported the results of that audit in Chapter 5 of our 2000 Report.

8.21 We did not examine the activities of other agencies such as the Royal Canadian Mounted Police that also have responsibility for protecting the Canadian border against the entry of illegal and smuggled goods. Nor did we examine the CCRA's enforcement under the Canadian Drug Strategy, the subject of another audit (Chapter 11 of this Report). We did not examine the work done by the Agency to ensure that exported shipments comply with applicable laws and regulations. For further details on our audit, see About the Audit at the end of this chapter.

Exhibit 8.3 Process for importing commercial goods into Canada


Pre-arrival
Shipment arrival
Inspection regime
Post-release regime
Declaration documents
Paper
Electronic
Other government entity permits
Customs
Primary inspection (at port of entry)
or
Release
Secondary inspection (at border facility or inland warehouse)
or
Release
Examine
or
Release
Detain or seize
Verification of selected importers
Accounting and payment
Accounting and payment

Risk assessment

- Identify high-risk shipments and contraband goods.
- Establish targets in automated systems to prompt inspection.

Primary inspection

- Screen shipments using declaration documents and targets in the computer system.
- Decide whether to release or refer to secondary inspection.

Secondary inspection

- Review declaration documents.
- Decide whether to release or examine.
- Examine shipments for contraband, commercial and trade requirements.
- Decide whether to release or to detain or seize the shipment.

Verification

- Check country of origin, valuation, tariff classification.
- Check permits, trade data for Statistics Canada.
- Review importer's accounting systems, books, and records.

Source: Canada Customs and Revenue Agency

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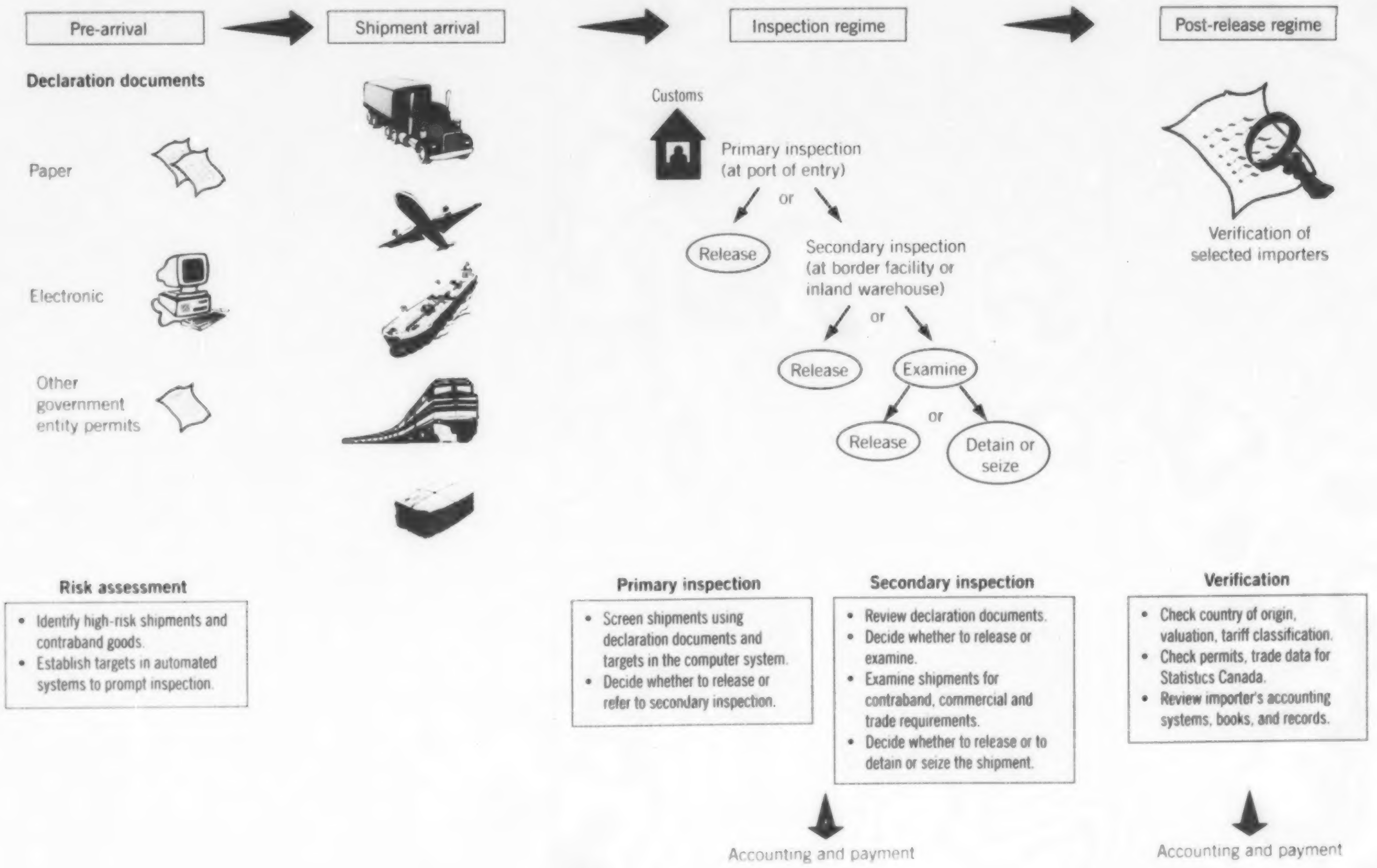
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Shipment arrival
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Verification of selected importers
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• Establish targets in automated systems to prompt inspection.
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Secondary inspection
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• Decide whether to release or examine.
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• Decide whether to release or to detain or seize the shipment.
Verification
• Check country of origin, valuation, tariff classification.
• Check permits, trade data for Statistics Canada.
• Review importer's accounting systems, books, and records.
Accounting and payment
Accounting and payment

Source: Canada Customs and Revenue Agency

Observations and Recommendations

Strategic direction

The 1990 Blueprint set a strategic direction for the decade

8.22 In March 1990, Customs issued *Customs 2000: A Blueprint for the Future*. The paper set out Customs' vision for moving into the year 2000, re-examined how Customs conducted business, and proposed an ambitious approach to managing the growing demand for its services.

8.23 For commercial operations, the Blueprint included the following objectives:

- strengthening enforcement activities aimed at protecting society;
- changing the approach for verifying that importers are following the rules; and
- streamlining the processing of commercial goods.

8.24 We looked at what the CCRA has done to implement these objectives. In general, we found that it has succeeded in making it easier for importers to bring legitimate goods into Canada and has worked hard to improve its enforcement activities. But it has had great difficulty implementing its Blueprint approach to verifying importers' compliance.

The Customs Action Plan and the Compliance Improvement Plan

8.25 By 1998, the CCRA recognized that even though it had not accomplished everything it set out to do in the Blueprint, changes in its operating environment meant it needed to rethink its vision. So it discussed several proposals with interested parties including employees, importers, brokers, and tourism associations. In April 2000 it released *Investing in the Future: The Customs Action Plan 2000–2004*. The plan sets out a new direction for the Customs program over five years.

8.26 In our view, the Action Plan's focus on risk management is sound. If implemented properly, the plan should help the CCRA achieve the overall goals of the Customs program.

8.27 In September 2000, the Agency issued the Compliance Improvement Plan for 2000–01. The plan began the process of adopting a systematic method of managing the Customs program based on risk. It was supported by a border management plan, a post-release verification plan, and a client services plan. The Agency recognized that the Compliance Improvement Plan would take a number of years to reach its full potential. In particular, there are a number of gaps in the information needed to develop a comprehensive plan and the CCRA is working to fill them in the first years of the plan. In our view, the plan is an important step forward for the Agency because it integrates all aspects of compliance in the Customs program.

Enforcement activities

Improvements are being made but challenges remain

8.28 The 1990 Blueprint stressed that Customs had to strengthen its enforcement activities to fulfil its responsibility for protecting Canadian society. Every shipment that crosses the border presents a risk for CCRA—

the possibility of drugs, pornography, weapons, endangered species, hazardous waste, and many others (Exhibit 8.4). Inspecting every shipment is neither desirable nor practical. The Agency is using a risk management approach to determine which shipments present the greatest risk so it can focus on those shipments and let the others pass through quickly. Finding these high-risk shipments is difficult. However, with the right strategies, techniques, and resources, the Agency should expect to have greater success.

Exhibit 8.4 Every shipment that crosses the border presents a risk

Illegal goods (contraband) that will enter Canada:

- cocaine, heroin, ecstasy, cannabis, and others;
- alcohol and tobacco;
- pornography, especially child pornography;
- weapons and firearms.

Inadmissible people who will enter Canada:

- illegal immigrants in containers;
- drivers with criminal records;
- missing children travelling with commercial drivers.

Restricted goods or goods needing permits that will enter Canada:

- endangered species;
- textiles, milk protein, and prescription drugs;
- dumped goods;
- hazardous waste;
- contaminated goods, like those with foot and mouth disease.

Importers, carriers, and drivers that will make incorrect declarations (innocently or intentionally):

- incorrect description of goods, including country of origin, quantities, value, end-use, and tariff classification (important for targeting);
- incorrect tariff classification, especially for machine release;
- incorrect calculation of duties.

8.29 The CCRA uses several techniques to identify high-risk shipments:

- In 1996–97 it prepared a national assessment of risks at ports of entry. The assessment was based on several factors that affect risk at each port, such as the volume of traffic, nearness to large cities, the history of seizures at the port, and knowledge of criminal organizations operating in the area. Each port was rated against these factors and ranked with the other ports by level of risk. The Agency is now updating that assessment.
- In 1998 it produced a national Contraband Risk Assessment. The assessment looked at the modes of transportation (highway, air, marine, and rail) and ranked them according to their relative risk of contraband.

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- The CCRA uses intelligence gathered from other Canadian and international enforcement agencies to detect links between importers and criminal organizations and set "look-outs" to help officers keep illegal goods from entering Canada.
- Its computers contain details about past seizures and other enforcement actions.

Further improvements are needed to identify high-risk shipments

8.30 Officials at headquarters and in the regions set targets in the computer system that flag high-risk shipments. We found some weaknesses in the targeting process:

- Determining whom or what to target is not an efficient process because officers have to refer to several computer systems. Even then, the officer may be lacking some information that would help with the task, particularly information about the results of examinations and the results of compliance verifications. Furthermore, ACROSS, the computer system used for targeting, is not user-friendly.
- The computer system can target specific importers, but it is difficult to target specific goods directly. To target specific goods, officers must determine which importers are likely to import those goods and then target those importers. This is becoming a lesser concern over time as the Agency encourages or requires importers to provide more information that will allow it to target specific goods.
- Studies have shown that contraband is more likely to be brought into Canada by a truck driver than an importer. The Agency uses its computer system to target high-risk importers, but it relies on manual systems and procedures to help identify high-risk truck drivers. It is evaluating the results of a recent pilot project that uses the computer system for targeting high-risk drivers.
- The effective use of targets relies heavily on the assumption that importers accurately describe the goods they are bringing into Canada. An accurate description of a shipment is important in making a decision to release it. While the Agency believes that most importers voluntarily comply with this requirement, it has few checks in place to ensure that they do at the time the goods are imported.

Inspection regime is stable and flexible

8.31 Identifying high-risk shipments is only the first step in the enforcement process. The next step is having an inspection regime that is effective at examining the shipments (Exhibit 8.3). The CCRA has three main triggers for an examination of commercial goods: targets in the computer system, random inspections generated by the system, and referrals by an officer.

8.32 The CCRA uses a primary inspection line, where officers screen shipments quickly. If the documentation is in order and the officer is satisfied that the shipment is a low risk, it is released without delay. If there are problems in the documentation or other indications that the shipment should be examined, the officer refers it to a secondary inspection team. This team of officers has more time to clear up problems in the documentation and decide whether to examine the shipment before releasing it.

8.33 The CCRA also uses other techniques to supplement the primary and secondary inspections:

- The Agency organizes blitzes, highly focussed examinations done over a short period of time. They usually involve several officers, so more examinations are done. Blitzes are especially useful for their deterrent effect. They also provide important information for setting new targets.
- The CCRA has introduced flexible response teams to improve enforcement, particularly for drugs. These teams are specially trained, and they move around within a port and between ports to help other officers.

The Agency also has specialized equipment such as X-ray systems and ionscans that help officers examine shipments more effectively.

8.34 In our view, the CCRA's inspection regime is stable and flexible and well understood by employees and importers. However, we are concerned about the situation at the Ambassador Bridge in Windsor. The bridge is the busiest land border crossing in the country, handling 6,000 to 7,000 trucks every weekday. The facility for examining shipments is about two kilometres from the bridge, through city streets. Officers at the bridge refer about a third of the trucks to the examination facility, in most cases so the paperwork can be completed to release the shipment. Unless officers escort a truck from the bridge to the facility, which rarely happens, the Agency cannot ensure that the truck goes directly to the facility or that no one tampers with the shipment. Some of the unescorted shipments may be high-risk. Management has advised us that to immediately address this concern it will issue a directive to all officers that will include guidelines on defining high-risk shipments, in order for officers to determine which shipments are to be escorted. The directive will also contain policies and procedures on escorting these shipments (Exhibit 8.5).

The border management plan sets goals and priorities for examinations

8.35 In 2000, CCRA produced its first national border management plan as part of the Compliance Improvement Plan for 2000–01. The plan laid out the expected number of examinations to be done in each region and set the examination priorities. The border management plan for 2001–02 reports the results of the first year and sets examination goals and priorities for the current year. This plan is an important step in further developing the CCRA's risk management approach. But the plan needs to be improved.

8.36 **The plan is based on incomplete data.** The information that the CCRA has been collecting on its enforcement efforts is difficult to retrieve in a format useful for analysis. Customs officers report the results of most examinations in one computer system and seizures in another. Other examinations are reported in a manual system. It is time-consuming and sometimes impossible to gather all this information and use it to develop a comprehensive plan.

8.37 **Balancing an optimum examination rate with resource constraints.** Examinations are an important part of the CCRA's goal to protect Canadian society. The number of examinations done varies among ports, from under

0.5 percent of commercial shipments in some to over 3 percent in others. The examination rate depends on such factors as the type of traffic at the port, the risks that have been identified, the ports' facilities, and the number of officers available to do the examinations. We expected to find an optimum examination rate for each port, based on its risks, and a planned examination rate that would balance the optimum rate with the available resources. This would also give managers an opportunity to compare the planned rate with the optimum rate and adjust resources if possible. We found instead that the planned examination rate was based on the resources and facilities available and no optimum rate was set.

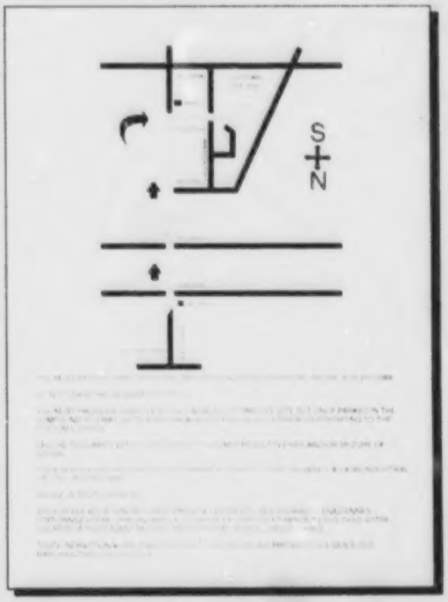
8.38 **Random examinations are important**. The CCRA's computers use statistical models to select shipments at random for examination. However, these models have not been reviewed for some time. The border management plan recommended that 13,800 random examinations be carried out in 2000–01. We found that 11,361 were actually done—a shortfall of 18 percent. Customs officers told us they pay less attention to conducting random examinations than targeted examinations if other operational priorities intervene. They believe that targeted examinations address a higher risk and therefore represent a greater chance of finding something. While this should be true, random examinations are especially important for deterrence. They help deter importers and others from trying to smuggle illegal or restricted goods across the border. They can also provide CCRA with some assurance about overall compliance levels and with new information for better targeting.

Exhibit 8.5 The Windsor examination facility is two kilometres from the Ambassador Bridge

At the Ambassador Bridge in Windsor, drivers are given instructions at the primary inspection booth on how to reach the examination facility. The Agency relies on the "honour system" for drivers to report there.

The current situation means the Agency cannot ensure that the truck goes directly to the facility or that no one tampers with the shipment between the primary inspection booth and the examination facility, unless the truck is escorted to the facility, which rarely happens.

Source: Canada Customs and Revenue Agency



F6

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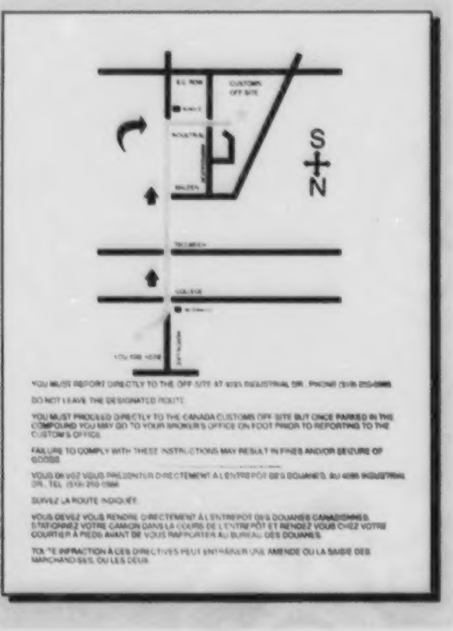


YOU MUST REPORT DIRECTLY TO THE OFF SITE AT [illegible] INDUSTRIAL DR. PHONE [illegible]

DO NOT LEAVE THE DESIGNATED ROUTE

YOU MUST PROCEED DIRECTLY TO THE CANADA CUSTOMS OFF SITE BUT ONCE PARKED IN THE COMPOUND YOU MAY GO TO YOUR BROKER'S OFFICE ON FOOT PRIOR TO REPORTING TO THE CUSTOMS OFFICE

FAILURE TO COMPLY WITH THESE INSTRUCTIONS MAY RESULT IN FINES AND/OR SEIZURE OF GOODS

VOUS DEVEZ VOUS PRÉSENTER DIRECTEMENT À L'ENTREPÔT DES DOUANES, AU [illegible] INDUSTRIAL DR., TEL. [illegible]

SUIVEZ LA ROUTE INDIQUÉE

VOUS DEVEZ VOUS RENDRE DIRECTEMENT À L'ENTREPOT DES DOUANES CANADIENNES. STATIONNEZ VOTRE CAMION DANS LA COURS DE L'ENTREPÔT ET RENDEZ VOUS CHEZ VOTRE COURTIER À PIEDS AVANT DE VOUS RAPPORTER AU BUREAU DES DOUANES.

TOUTE INFRACTION À CES DIRECTIVES PEUT ENTRAÎNER UNE AMENDE OU LA SAISIE DES MARCHANDISES, OU LES DEUX

Source: Canada Customs and Revenue Agency

Examination results do not show whether the Agency's approach to risk management is working

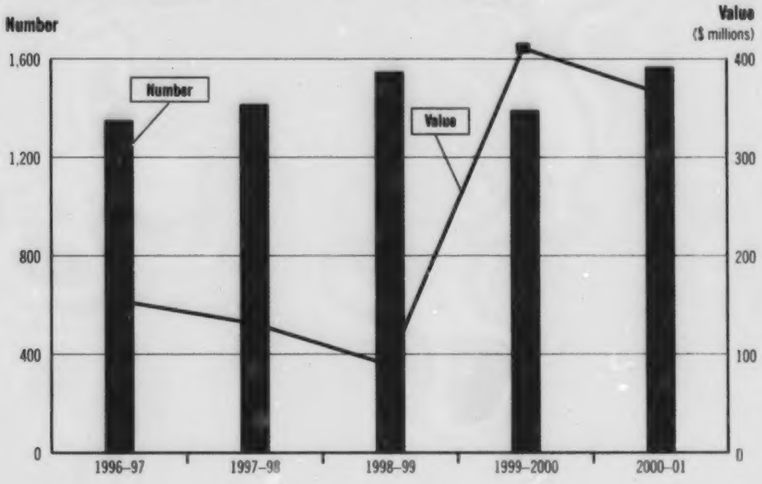
8.39 The results of examinations and enforcement actions are important indicators of whether the approach to risk management is working. They also indicate whether the CCRA is protecting Canadians effectively and whether people and goods crossing the border are complying with Canadian laws.

8.40 When we reviewed the data on examinations, we looked for information that would show us the following:

- examination rates, including the hit rate (number of seizures in the examinations done);
- the number of seizures and the quantity of goods seized;
- whether the new processes to speed up low-risk shipments made more resources available to examine high-risk shipments;
- whether the Agency was doing more (or more in-depth) examinations of high-risk shipments than in previous years;
- whether improved targeting activities were leading to more enforcement actions; and
- a measure of overall compliance levels at the border.

8.41 We found that the Agency has information on seizures (Exhibit 8.6), and it has reported the value of seizures to Parliament for many years. It has used this information to help identify high-risk shipments.

Exhibit 8.6 Number and value of commercial seizures in the last five years



Source: Canada Customs and Revenue Agency

8.42 In many other respects, what our review showed was disappointing:

- The CCRA has information for only the last three years on the number of examinations done, the hit rate in those examinations, and the origin of the referral for each examination. And this information may not be accurate, because it is collected in several systems that are not integrated. This limited amount of information makes it difficult to assess enforcement efforts over time and set proper enforcement goals.
- The CCRA does not know whether more resources are available to examine high-risk shipments, because it does not collect that type of information. We think it should, because it has frequently said that this would be one of the results of its efforts to speed up the processing of low-risk shipments.
- The Agency does not know if it is doing more (or more in-depth) examinations of high-risk shipments than in previous years. Nor does it know whether its improved targeting activities have led to more enforcement actions. Again, the Agency does not collect that type of information.
- The CCRA says that based on its "stint" examinations, compliance at the border is between 87 percent and 98 percent. The rate varies depending on the mode of transport and the year the stint was done. Stints are random examinations at selected ports for the purpose of measuring compliance at the border. They examine the release documentation on a shipment to see whether it is complete and properly describes the shipment, and whether drugs or other contraband were found in the shipment. However, the results of the stints are not tied in with compliance verification results to provide a more complete picture of compliance levels.

8.43 **Recommendation.** The Agency should do the following:

- improve the efficiency of the targeting process by ensuring that targeters have easy access to all relevant information;
- improve the effectiveness of the targeting process by more systematically monitoring release documents to ensure that they properly describe the goods being imported into Canada;
- conduct random inspections more faithfully and analyze their results more carefully; and
- collect the information needed to assess the effectiveness of its risk management approach, including information to show whether targeting activities are identifying high-risk shipments, resources are being used to examine high-risk shipments, and resources are being allocated to achieve an optimum examination rate.

Agency's response. The Agency will continue to improve the accessibility of targeting information and is currently exploring options to improve the targeting process by enhancing its computer systems. Options under consideration include enhancing the targeting capability at the Primary Inspection Line (PIL) and creating new interfaces between systems. Implementation will be subject to the availability of systems and financial resources.

The Agency continues to make efforts to improve the monitoring of release documents to ensure that they properly describe the goods being imported. As part of the Customs Action Plan, increased reporting requirements for commercial shipments will be introduced to improve our targeting capability. The Administrative Monetary Penalty System (AMPS), another Customs Action Plan initiative, will support the compliance monitoring of release documents by providing the framework for issuing warnings and penalties where cases of non-compliance are detected. The first phase of these initiatives will be implemented in the spring of 2002, subject to the passage of the necessary legal framework.

The Agency will make efforts to ensure that random inspections are conducted more faithfully and will continue to improve the analysis of results as part of the Border Management Plan.

The Agency will explore opportunities to improve the type of information available to determine the effectiveness of our risk-management approach.

Verifying importer compliance

The CCRA had great difficulty implementing its approach

8.44 Compliance verification, making sure importers are following Customs trade laws and regulations and paying the right customs duties, is a key activity in the Customs program. Over the years, changes in trade agreements and trading patterns have shifted the focus of compliance verification. Today, the Agency focusses more on making sure importers have followed the rules in the agreements than on collecting revenue: the agreements often reduce customs duties or even eliminate them. The Agency also has to make sure it collects accurate trade data, which the government needs to ensure that Canada is complying with the terms of its trade agreements and to negotiate new agreements.

8.45 To help speed up processing at the border, the CCRA usually does compliance verification after goods have been brought into the country. Some aspects of compliance verification are done at the border, however—examining labels and markings on goods, for example. Verification officers use the release and accounting documents that the importer has filed with the CCRA. In some compliance verifications, the CCRA will also assess the importer's accounting systems to see if they can report the imported goods accurately to the Agency.

8.46 The main objective of the verification work is to get answers to some or all of the following questions:

- Is the tariff classification correct?
- Has the right tariff preference been claimed?
- Have the goods been properly valued?
- Are the quantities correct?
- Is the country of origin correct?
- Have all the required permits to import the goods been received?
- Have the statistical requirements for trade data been met?

8.47 In the 1990 Blueprint, the CCRA said that it needed to change its approach to compliance verification and, since 1993, it has made major changes. These changes were made while the organization itself was changing (Exhibit 8.7). Before 1993, Customs' focus was on verifying individual transactions or shipments. The new approach was designed to provide a better picture of overall levels of compliance. For some importers, this involved a comprehensive, periodic verification of the importer's accounting systems and a review of a sample of the importer's transactions to ensure that they were reported correctly to Customs. In other cases, such as single program reviews, this involved reviewing specific issues for a number of importers.

8.48 While the Agency focussed much of its attention on implementing its periodic verification approach, transactional reviews continued until 1997 and single program reviews became increasingly important. They identified areas of non-compliance by the importers reviewed. However, the results of those reviews were not analyzed on a national basis to provide a picture of overall compliance or identify areas potentially at high risk of non-compliance. Furthermore, verification officers told us they did not receive appropriate guidance on how to assess risks in these reviews and how many reviews they should do. More attention has been paid to single program reviews recently. In July 2001, the Agency started to incorporate single program reviews in its 2001–02 post-release verification plan, and it reflected the expected results of all verification activities in the accountability agreements of responsible managers and directors.

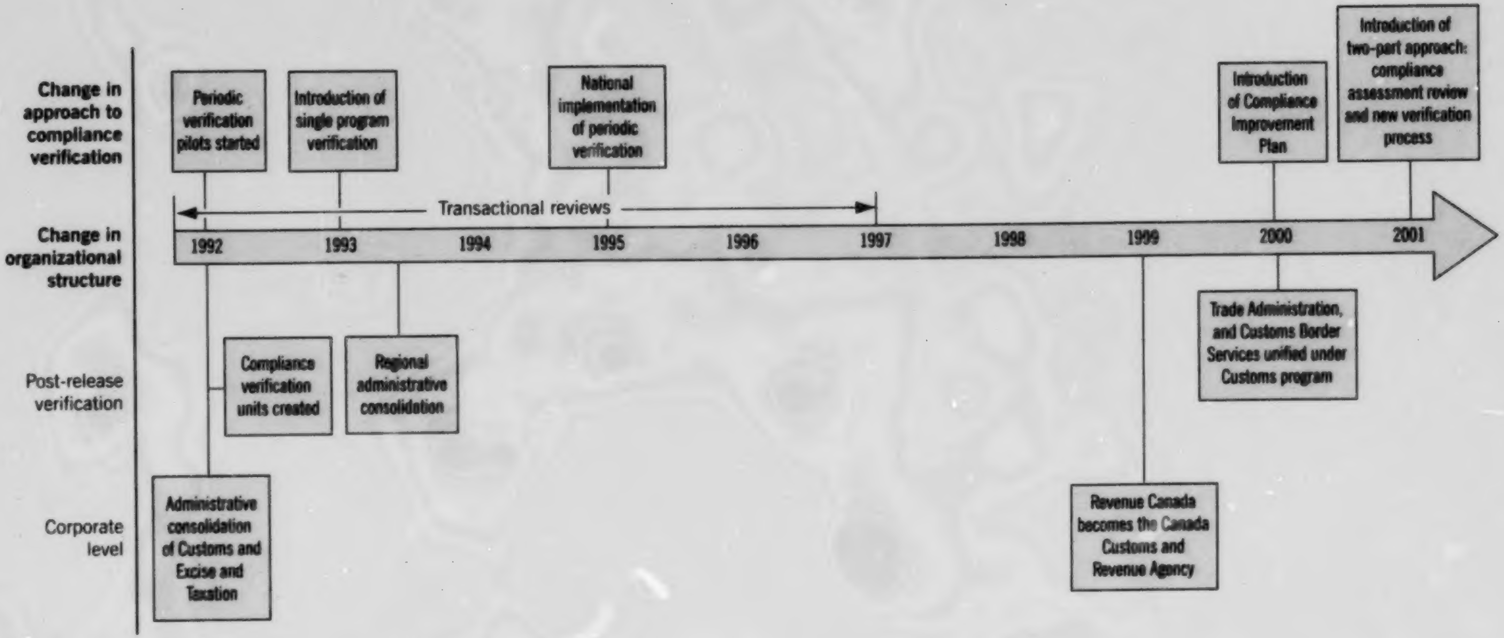
Periodic verification achieved little at great cost

8.49 In our 1994 Report we commented on the periodic verification approach. We were encouraged by the forward thinking it represented and by the results of the pilot projects. We noted that Customs had set ambitious goals for the approach, but that it did not have a detailed implementation plan to guide it in achieving those goals. In our 1997 follow-up, we noted that Customs had not made as much progress as it had expected.

8.50 This year we found that progress had continued to be slow. By the end of the first phase of the implementation process in 1998, Customs had completed 53 of the planned 187 verifications. The Agency's internal auditors reported that by the end of 1999, 135 verifications had been completed. Since we initiated this audit, the Agency has worked hard to complete verifications. By August 2001, it had completed 374 verifications and 367 were in progress.

8.51 The CCRA assessed the 53 verifications completed in phase I of the program. The major objective was to determine how compliant importers were in providing correct trade data. It reported high error rates in classification (29 percent), origin (18 percent), and valuation (15 percent). In some sectors the error rates were over 50 percent. More significant, 48 of 53 companies verified had made errors in classification. The Agency has not analyzed the results of completed verifications since 1998 and cannot show whether compliance has improved or deteriorated since then.

Exhibit 8.7 Change in Customs' approach to verifying that importers follow the rules

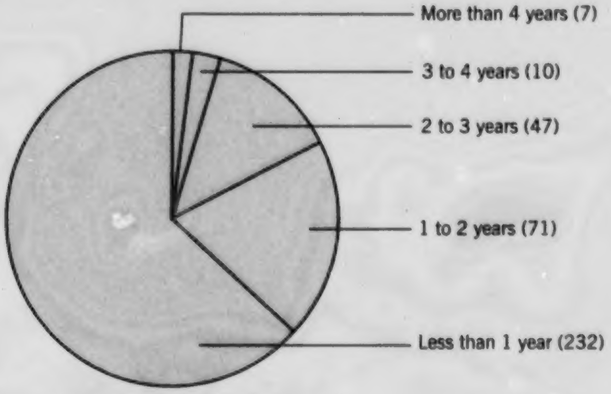

Change in approach to compliance verification
Change in organizational structure
Post-release verification
Corporate level
Periodic verification pilots started
Introduction of single program verification
National implementation of periodic verification
Introduction of Compliance Improvement Plan
Introduction of two-part approach: compliance assessment review and new verification process
Transactional reviews
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
Compliance verification units created
Regional administrative consolidation
Trade Administration, and Customs Border Services unified under Customs program
Administrative consolidation of Customs and Excise and Taxation
Revenue Canada becomes the Canada Customs and Revenue Agency

Source: Canada Customs and Revenue Agency

8.52 Completing each verification has taken much longer than Customs had anticipated. For many reasons, some of which are outlined in paragraph 8.54, 46 of the completed verifications took as long as three years. We calculated how long the Agency has been working on the periodic verifications it has not yet completed. We found that 135 have been going on for more than a year (Exhibit 8.8). These delays have caused difficulties and added costs for both the CCRA and the importers involved. The Agency is attempting to deal with some of these delays with a new verification approach, which is discussed in paragraph 8.59.

8.53 In our view, the concept of periodic verification is sound, but the CCRA has had great difficulty implementing it properly. After six years and a lot of effort, it has made little headway in assessing how well importers are following the rules. Furthermore, the initiative has left verification officers and some importers frustrated.

Exhibit 8.8 Delays in completing periodic verifications



367 incomplete verifications

Note: Number of incomplete verifications by August 2001 in parentheses.

Source: Canada Customs and Revenue Agency

Verification officers encountered many problems

8.54 To understand why it was taking so long to complete the periodic verifications, we interviewed headquarters officials, verification officers and their managers. As well, we reviewed internal audit reports and other documentation. We also surveyed a sample of verification officers across Canada. The survey results confirmed what we learned during our field visits. Verification officers told us they had several concerns:

- The methodology for periodic verifications was weak. The guidelines and manuals did not give verification officers enough guidance to help them do the work. The methodology became outdated and regions had to update it themselves, raising the concern that it was not being applied consistently.

- Headquarters did not provide timely guidance on how to apply the methodology or how to interpret policies. This increased the time that verification officers had to spend.
- It was difficult for verification officers to get guidance from their local managers on how to conduct the verifications, because managers changed positions frequently.
- Verification officers told us they did not get enough orientation and ongoing training to help them adapt to the new approach. The training they did get was often delayed.
- Verification officers have limited opportunities to share the knowledge and skills they learn on the job and better ways of doing the job. This is an important part of applying a new approach.
- Verification officers did not receive regular feedback and coaching from their managers to help them perform better.
- Importers did not always respond to requests for documentation in a timely manner.
- It was difficult for verification officers to get money for the travel the job entailed.

8.55 The training issue raised by the verification officers needs to be explained. Periodic verification requires that officers have a sound knowledge of auditing techniques, accounting practices, and trade regulations, so they can examine an importer's accounting systems properly and ensure that the importer has followed the rules. They also have to work as part of a team. For the most part, the officers who had been doing the transactional reviews needed extensive training in auditing techniques and accounting practices to make a successful transition to the new approach.

8.56 Headquarters and the regional offices gave the verification officers some training, including two accounting and auditing courses. But officers told us it was not enough to help them do the new job well. They also told us they did not find that the training provided by headquarters was effective. While the Agency tried to use its taxation auditors on the verification teams because they have the required accounting and auditing knowledge, these auditors were not always available when needed.

8.57 **Problems with the national computer system.** We also found that the national computer system for recording the results of verifications and other performance information does not meet the needs of compliance verification managers and officers. The system is outdated and not user-friendly. Officers are using various local systems that are not integrated. This means that verification officers in one region cannot look up information on similar cases in other regions to help them with their work. It also makes it difficult for the CCRA to get an accurate picture of current compliance levels, identify areas of highest risk, or determine where it should focus resources. In July 2001, headquarters prepared a business case for a national system to capture the results of all post-release verification activities.

8.58 **Fallout on the work force.** Verification officers we surveyed told us they had other frustrations that have affected their morale, in addition to their specific problems with the periodic verification approach:

- The CCRA has gone through several reorganizations and realignments since 1990. Verification officers said they have not received enough support to help them cope with the uncertainty that these reorganizations bring.
- Many regional managers have been in acting positions for some time, and officers told us this creates an atmosphere of instability. In the last five years, 156 people have filled the 71 manager positions in compliance verification units. And 115 of those people (74 percent) were acting in the position (Exhibit 8.9).

8.59 **A revised approach is promising.** The CCRA has had problems with its periodic verification approach for some time. In 2000, it piloted a new two-part approach for verifying importers' compliance, which includes compliance assessment reviews and a new verification process (Exhibit 8.10). Training in the new approach had been completed for two regions during our audit and is planned for the other four regions this fall. The pilots have been assessed and the results are encouraging. However, given the problems the Agency had with the periodic verification approach, we believe it will have to do much more this time if the new approach is to succeed.

Post-release verification plan needs improvement

8.60 In September 2000, the CCRA introduced the post-release verification plan for 2000–01, one of the three plans supporting the Compliance Improvement Plan. The purpose of the plan was to bring together all post-release verification requirements and establish national priorities. The Agency issued the post-release verification plan for 2001–02 in July 2001.

8.61 We are encouraged by the progress the Agency has made with these plans in the past year. However, further improvements are needed to set a firm direction for compliance verification. These include the following:

- The CCRA needs better information to determine what issues or trends it should emphasize and to identify the priority areas or sectors for

Exhibit 8.9 Turnover of regional management in compliance verification units over the last five years

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	6	10	30	4	15	6	71
[illegible]	18	43	52	11	23	9	156
[illegible]	13	32	40	9	17	4	115
[illegible]	72%	74%	77%	82%	74%	44%	74%

Source: Canada Customs and Revenue Agency

verifications. The plans acknowledge that critical data are lacking and priorities are based mainly on anecdotal information and the intuition of trade experts. Better information would include the results of verifications, compliance trends and issues, industry sector compliance rates, revenue collected from compliance verifications, and links with border examinations.

- The Agency needs better information about an importer's compliance history. Currently, it decides what priority areas or sectors to focus on and then randomly selects the importers in those areas or sectors for verification. If it knew more about the importers, it could select those least likely to be complying with the laws.
- The plans do not provide for the overall coverage the CCRA wants and expects to give it sufficient assurance that importers are following the rules.
- The Agency bases the number of verifications it plans mainly on the number of officers available to do the work.
- The CCRA needs national standards sufficient to ensure that verifications of all importers are consistent, in both their quality and their coverage of the risks of non-compliance.

Exhibit 8.10 A new two-part approach replaces periodic verification

As part of the Compliance Improvement Plan, post-release verification is being changed to take a more risk-managed approach. Verification will focus on non-compliance. The new two-part approach will replace periodic verification and will include the following:

Compliance assessment review

- Relies on an understanding of the importer's business, accounting records, and types of import transactions. This is critical because it helps identify the relevant types of transactions to be considered in drawing an appropriate sample for review.
- Requires compliance verification officers to review a company's business systems and its importer processes and controls to identify strengths and weaknesses and determine the scope of the verification.
- Uses a much smaller sample size than periodic verification. Based on the results of a sample of companies in priority commodity sectors, determines any identifiable trends of non-compliance.

New verification process

- Designed to focus on specific risks identified in the compliance assessment review. It can be limited to one program or include several. It is a targeted verification process that will provide a streamlined and consistent national approach to verification.
- Selects an appropriate sample of transactions from the CCRA's or the importer's records; however, the sample size will vary from issue to issue. Requires compliance verification officers to select an appropriate sample, using guidelines developed to assist them.

Pilots for the compliance assessment review and the new verification process have been conducted successfully in various regions. The CCRA intends to roll out the two-part approach in the regions and develop performance measures and standards. Regional training was under way until the end of October 2001. By end of the year, the CCRA anticipates that the new two-part approach will be implemented in all regions.

Source: Canada Customs and Revenue Agency

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	Pacific	Prairie	Southern Ontario	Northern Ontario	Quebec	Atlantic	Total
Number of manager positions	6	10	30	4	15	6	**71**
Number of people in these positions	18	43	52	11	23	9	**156**
Number of these people acting in the position	13	32	40	9	17	4	**115**
Percentage acting in the position	72%	74%	77%	82%	74%	44%	**74%**

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Source: Canada Customs and Revenue Agency

8.62 We compared actual results achieved under the new approach for 2000–01 with planned results. By 31 March 2001, verification officers had completed only 53 percent of the planned verifications—covering 59 percent of the import value the Agency wanted to cover (Exhibit 8.11). Incomplete verifications have been carried over to 2001–02. The 2001–02 post-release verification plan is in some jeopardy because of the slippage. The Agency needs to better analyze why it is not meeting its targets and then develop a workable strategy and plan that will help it achieve appropriate coverage with its verifications.

Exhibit 8.11 Verifications planned and completed in priority sectors in 2000–01

	Verifications*	Import value ($ millions)	Percentage of import value
Total import value	–	23,986	100
Verifications planned	152	3,141	13
Verifications completed	80	1,862	8
Percentage completed	53%	59%	–

*Verifications of importers selected from priority sectors, which include steel, textiles and apparel, footwear, and tariff rate quotas for milk proteins and chicken.

Source: Canada Customs and Revenue Agency

8.63 **Recommendation.** The Agency should do the following:

- collect the information needed to assess the effectiveness of all compliance verification activities and set goals for future activities that will provide assurance that importers are following the rules;
- analyze the results of completed periodic verifications and determine whether compliance has improved or deteriorated since 1998;
- analyze the results of completed single-program reviews to identify high-risk areas of non-compliance;
- ensure that the training provided to compliance verification officers, particularly in the areas of accounting and auditing, is appropriate, timely, and evaluated for its effectiveness;
- develop a national computer system to capture the results of all post-release verification activities; and
- develop an action plan to implement the new two-part approach to verifying importers' compliance, including methodology development, training, and ongoing officer support.

Agency's response. The Agency agrees with the recommendation. The implementation of the Compliance Improvement Plan in April 2000 provided for a comprehensive, integrated, risk-based approach to compliance for all Customs programs. As this process evolves, it will allow the Agency to ensure the effectiveness of all of its compliance verification activities and to set goals for future activities.

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To aid in this process, the Agency will continue to capture and track the results of all post-release verification activities. The Agency will be monitoring and analyzing these data as we move through the Compliance Improvement Plan process to ensure that its efforts are effective in improving and sustaining compliance.

The Agency is currently developing both a short-term and a long-term system solution to allow us to capture and analyze the results of all post-release verification activities, including single-program reviews. The design and implementation of the new long-term system solution will be subject to the availability of systems and financial resources.

The Agency has established a national working group on training and learning, comprising regional and headquarters functional specialists to guide the future development of a national, core curriculum for compliance verification officers (CVOs) and client services officers (CSOs) for all trade and customs-related matters. As part of this work program:

- The Agency will finalize and distribute a new, generic, national, introductory course for CVOs, entitled Introduction to Trade Services, for use in the regions during 2001–02.
- The Agency is also currently evaluating a basic accounting self-study course and will adapt it to CVO needs as required. It will also explore a variety of other accounting and on-site verification/auditing courses to determine those best suited for CVOs.
- The Agency will elaborate a core curriculum and a long-term learning strategy for beginner, intermediate, and senior compliance verification officers during 2002–03 to ensure that the training provided to CVOs is appropriate, timely, and evaluated for its effectiveness.

The Agency will develop an action plan by the end of December 2001, to address the implementation of the new two-part approach to verifying importers' compliance. This action plan will be monitored to ensure the continued effectiveness of the verification processes.

Release of shipments

Shipments are now being released faster at the border

8.64 The 1990 Blueprint set out several ways that Customs hoped to streamline the processing of commercial goods:

- provide more service options to meet the individual needs of importers;
- increase the use of electronic data interchange (EDI) to exchange release and accounting information with its clients;
- have importers send information to Customs for review before a shipment arrives so it can process the shipment faster;
- register certain regular importers and pre-approve their imports of specific goods; and
- improve its enforcement capabilities so it can carry out inspections more efficiently.

8.65 The CCRA has successfully implemented these aspects of the Blueprint. Many commercial shipments now clear the border in less than five minutes under normal circumstances. In particular, importers who are pre-approved and those who send the required information to the CCRA before the shipment arrives experience little delay of their shipments. Most delays at the border now occur because importers do not have their documentation ready when the shipment arrives or because traffic is congested.

8.66 In most cases, the problem of traffic congestion is beyond the Agency's control; it is caused by overcrowded roads, bridges, and airports. It is most acute in southern Ontario, where all highway crossings into Canada are by bridge or tunnel. These are the crossings with the most traffic. For example, about 2,000 trucks enter Canada every day across the Peace Bridge at Fort Erie, and they have to share the bridge with tourists and returning Canadians.

Significant accomplishments

8.67 The CCRA now meets the individual needs of importers better by providing several ways for them to have their goods released:

- full accounting and payment of all duties and taxes at the time of release;
- release with minimum documentation, followed up with a full accounting within five days of release;
- transmittal of information about the shipment before it arrives, followed up with a full accounting within five days of release; and
- pre-approval for certain importers to import specific goods at any time, followed up with a full accounting within five days of release.

8.68 About 65 percent of releases and 98 percent of accounting transactions are now processed through EDI. This is more efficient for the CCRA and improves its service to importers and brokers. For example, the CCRA's service standard for paper releases is two hours, but for EDI releases it is 45 minutes.

Machine release needs closer monitoring

8.69 One of the benefits of electronic transmission of information by importers is that the Agency can use its computers to analyze the information. This increases efficiency and frees up officers' time for other important activities. The CCRA uses its computers to recommend that goods be released for about 18 percent of all shipments. This is called machine release.

8.70 Importers send the required information to the CCRA electronically, including the tariff classification of the goods they are importing. The Agency's computers verify that the importer is eligible for machine release and that the goods can be imported into Canada. If the shipment has already arrived, the computer releases the goods. If it has not, the computer recommends that the goods be released and when the shipment arrives, an officer decides whether to release the goods immediately or examine them first.

8.71 The CCRA decides which importers are eligible for machine release based on their compliance records. We found that the procedures it follows to make the decision are not as thorough as they should be. For example, it does not consider the results of an importer's compliance verifications, and yet these verifications are important to know how well the importer has followed the rules. Furthermore, the CCRA does not review its eligible importers regularly to ensure that they have kept their compliance records clean.

8.72 **Recommendation.** The Agency should systematically review the compliance records of importers that receive special release privileges, including machine release.

Agency's response. The Agency will continue to make efforts to ensure the systematic review of the compliance records of importers that receive special release privileges, including machine release.

An action plan to improve the authorization process and the monitoring of the machine release program and other special release privileges is currently being developed.

The Agency will continue to review the compliance records of CSA (Customs Self-Assessment) clients as part of the application and approval process. Once a client is approved for CSA, the Agency will systematically monitor compliance. A new client profile system is currently being developed to support this new monitoring function. The first release of this new system is planned for December 2001.

Measuring performance

New performance report provides more information

8.73 The overall objective of the Customs program is "to protect Canadian society and promote the competitiveness of Canada through the facilitation of international trade and tourism balanced with responsible border management." We expected to find performance measures that would show how well the Agency meets this objective.

8.74 We found that the performance reports to date on the commercial aspects of the Customs program have been limited. The Agency has provided information on the volume of transactions processed and the total value of seizures, as well as updates on specific initiatives. There have been no performance measures to show how well it is protecting Canadian society or promoting Canada's competitiveness.

8.75 As part of the legislation that created the Agency, Parliament required it to report annually on how well it has achieved its objectives. At the time of our audit, the Agency was preparing its first performance report that will include information on the Customs program. The Agency's performance report will include our assessment of that information.

8.76 The Agency has developed five high-level performance measures for the Customs program and rated itself on meeting those measures. It has described how it arrived at the ratings and supported this with quantitative information where possible. The Agency acknowledges, however, that it is not collecting enough information to analyze in any systematic way whether it is achieving its objectives in the Customs program.

8.77 **Measuring the compliance levels from beginning to end.** Measuring the compliance levels overall and by industry sector would be important measures of how well the CCRA is doing its job in the Customs program. The CCRA already measures compliance levels at the border through its "stint" examinations. This information could be expanded to include compliance levels as measured by compliance verification activities. An integrated measure for both aspects of the Customs program would provide an overall compliance level, indicating how well importers followed the rules. It would also signal areas of non-compliance to help the CCRA focus its efforts better at the border and in compliance verification. Comparing compliance levels over a number of years would indicate whether the Agency's activities to address identified areas of non-compliance had succeeded in improving compliance.

Setting expectations is part of the process

8.78 An important part of measuring performance is to set expectations and measure actual performance against them. Concrete expectations of performance indicate the desired direction and "how much" of the desired result is sought. Without this indication of "how much," it is impossible to assess whether the accomplishments reported are adequate, show progress, or meet expectations fully.

8.79 The new Compliance Improvement Plan sets expectations for numbers of examinations, compliance verifications, and client service actions. It is important for the CCRA to report its actual results against these expectations and explain the differences, and it is starting to do this.

8.80 Exhibit 8.12 shows some of the measures that other customs services use to show how they are performing. These agencies also set performance expectations that use these measures, and they prepare an accountability report each year on whether they have met the expectations. When they have not, they explain why.

8.81 **Recommendation.** The Agency should develop the detailed performance measures needed to show that it is achieving its objectives in the Customs program. It should set expectations for each of the measures and collect appropriate information to evaluate actual performance against expectations.

Agency's response. The Agency recognizes the importance of the generation and use of meaningful performance measures and this continues to be a priority for the Customs program.

Customs is participating in the Agency-wide implementation of the Balanced Scorecard methodology to improve performance management for our programs. Integral in this exercise is the validation of existing data sources, identification of data deficiencies, and identification of opportunities to improve the use and validity of data in order to evaluate performance achievements in relation to our performance expectations.

Exhibit 8.12 Some performance measures and targets used by other customs services

[illegible]	[illegible]
Australian Customs Service	
• Percentage of electronically lodged import entries processed within 15 minutes	97%
• Percentage of manually lodged import entries where advice of ready to pay is given within 4 hours of receipt in Customs of a complete and accurate entry	97%
• Trend in the number and weight of drug seizures of illicit drugs	Weight and number of seizures
• Trend in number of detections and/or seizures of other prohibited imports	Number of detections and/or seizures
• Percentage availability of electronic systems to Customs clients	99%
• Percentage of total cargo entries subjected to revenue protection processes	100%
• Total revenue subjected to compliance audit activity as a percentage of total revenue responsibility	15%
• Amount of revenue adjustments as a result of compliance audit activity	Recoveries: $20 million Refunds: $2 million
U.S. Customs Service	
• Percentage of compliance for all trade transactions	90%
• Percentage of compliance for Primary Focus Industries transactions	95%
• Percentage of compliance for NAFTA transactions	95%
• Percentage of compliance rate for key statistics accuracy	90%
• Percentage of compliance rate for revenue collection	99%
• Increase number of nationally managed importer accounts	800 by 2004–05
• Increase number of reported lines in Automated Entry System (AES)	16.6 million by 2003–04
• Increase number and percentage of AES participants	x number and x %
• Increase number and quantity of narcotics seizures	x number and x quantity

Source: Adapted from the 2000–2005 *Strategic Plan* of the U.S. Customs Service and the 1999–2000 *Annual Report* of the Australian Customs Service

The Action Plan looks to the future

8.82 *Investing in the Future: The Customs Action Plan 2000–2004* is the CCRA's plan to change the Customs program in the near future. The plan has two main features: risk-based processes for travellers and traders and a fair and effective sanctions regime. The goal of the risk-based processes is to make it easier for low-risk people and goods to cross the border and make it harder for higher-risk people and goods.

8.83 The Action Plan builds on many of the 1990 Blueprint concepts. For example, the Blueprint proposed a new penalty regime that would be fairer and quicker to apply. The Agency has designed an Administrative Monetary Penalty System as part of the Action Plan and has presented the necessary legislation for Parliament's approval.

Compliance verification is critical for Customs Self-Assessment

8.84 As part of the risk-based processes for traders, the CCRA is planning to implement Customs Self Assessment (CSA). CSA is a dramatic shift in the way the Agency does business at highway border crossings (Exhibit 8.13). Importers, carriers, and drivers will apply for CSA privileges and will be

Exhibit 8.13 The Agency's Customs Self-Assessment program

The Customs Self-Assessment (CSA) program allows approved importers to release and account for their commercial shipments more quickly. Some aspects of the initiative require changes to the *Customs Act;* these are currently contained in Bill S–23, which is before the House of Commons. The Agency is processing applications and expects to have CSA in place for highway shipments when the legislative changes are done.

Objective

- Provide simpler release procedures at the border for low-risk shipments.
- Eliminate the need to confirm shipments five days after release.
- Process a monthly declaration by the importer.
- Free up Agency resources to focus on more high-risk shipments.

Process

- When a CSA shipment crosses the border, the Agency records the importer, carrier, and driver. There is no need for the Agency to release the shipment.
- Importers will report all imports monthly and pay the duties and taxes owing.

Conditions

- Importers, carriers, and drivers must apply to the Agency to be CSA-approved.
- Importers must have a good compliance history and frequent low-risk shipments.
- Carriers and drivers must have a good compliance history.
- Importers and carriers must demonstrate they have adequate business systems to track and account for imported goods and shipments.
- Shipments do not require permits for other government entities.

Verification

- CSA shipments remain eligible for random inspection at the border.
- Compliance verification units in the regions will assess importers' accounting systems, books, and records to ensure compliance.

Source: Canada Customs and Revenue Agency

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- Importers will report all imports monthly and pay the duties and taxes owing.

Conditions

- Importers, carriers, and drivers must apply to the Agency to be CSA-approved.
- Importers must have a good compliance history and frequent low-risk shipments.
- Carriers and drivers must have a good compliance history.
- Importers and carriers must demonstrate they have adequate business systems to track and account for imported goods and shipments.
- Shipments do not require permits for other government entities.

Verification

- CSA shipments remain eligible for random inspection at the border.
- Compliance verification units in the regions will assess importers' accounting systems, books, and records to ensure compliance.

Source: Canada Customs and Revenue Agency

approved if they are considered a low risk. The approval process will give the Agency more information on who is crossing the border.

8.85 The CCRA will use a different process at the border for CSA-approved importers. The Customs officer will check that the importer, carrier, and driver are CSA-approved and will decide whether the shipment needs to be examined. The officer will record that the shipment has crossed the border, but will not release the goods; they will be considered released when the importer receives them. Approved importers will account once a month for all goods they have imported into Canada. The Agency has already tested many of the key features of the CSA initiative.

8.86 The compliance verification regime is critical in a CSA environment. While the Agency will continue to do random examinations at the border, it will do most of the verification work after the goods have entered Canada, based on the information provided by the importer. Earlier in this chapter we pointed out that the CCRA has ongoing problems with its compliance verification regime. The new two-part approach it is testing has not been proved or fully implemented (Exhibit 8.10). Therefore, we are concerned that the CCRA is going ahead with CSA before its compliance verification regime is solidly established.

Conclusion

8.87 The CCRA has faced a lot of changes in its Customs program over the past decade. The North American Free Trade Agreement has generated a big increase in the volume of commercial imports. The CCRA has not increased the resources used to deliver the Customs program; it has looked for ways to improve its efficiency while protecting Canadian society.

8.88 In our view, the 1990 Blueprint and the 2000 Customs Action Plan included many good ideas to help the CCRA achieve its objectives. We found that the Agency has done well with its Blueprint initiatives for speeding up the release of shipments at the border. We also found that it has worked hard to improve its enforcement regime, but important challenges remain. In particular, the CCRA needs to further improve its targeting of high-risk shipments and show that its risk management approach is working. Finally, we found that the Agency has had great difficulty implementing its approach to verifying importers' compliance; it needs to focus more closely on its newest approach.

8.89 The CCRA is not yet providing Parliament and Canadians with enough information on the performance of the Customs program. The Agency's new performance report is promising. But it needs to collect and analyze much more concrete information if it is to demonstrate that it is achieving its objectives in the Customs program.

About the Audit

Objectives

The objectives of our audit were the following:

- to assess whether the CCRA's risk management strategy for identifying and targeting high-risk shipments and its inspection regime have been satisfactorily designed, implemented, and monitored to achieve its objective of protecting Canadian society and industry;
- to assess whether the CCRA's post-release verification regime has been satisfactorily designed, implemented, and monitored to achieve its objective of ensuring compliance; and
- to determine whether the CCRA has measured and reported the results of its inspections and post-release verifications.

Scope and approach

The audit focussed on the CCRA's inspection of shipments identified at random or targeted under its risk management strategy and on subsequent post-release verifications of commercial shipments entering Canada.

Our examination included a review of the CCRA's risk management strategy and targeting techniques, border inspections, and post-release verification processes. We conducted our work in Customs' headquarters in Ottawa and at various regional offices and selected ports of entry. Our work included interviewing Customs management and staff, stakeholders, and other government department officials and union officials as appropriate. We surveyed a selected sample of compliance verification officers for their opinions. We reviewed and analyzed relevant processes and documents.

Criteria

Our audit was based on the following criteria:

- The CCRA's risk management strategy should be clearly stated. Appropriate criteria should be established to assess the risks associated with the movement of goods across the border.
- The CCRA's inspection regime should be satisfactorily designed, implemented, and monitored to prevent the movement of contraband and hazardous goods across the border.
- The CCRA's post-release verification regime should be satisfactorily designed, implemented, and monitored to ensure compliance.
- Headquarters should provide functional guidance and assist the regions in implementing the inspection and post-release processes.
- Customs should have the capacity in place to satisfactorily conduct inspections and post-release verifications.
- Customs should measure and report on the results of the inspection and post-release verification regimes for purposes of accountability and continuous improvement.
- Customs should have effective working relationships with other government departments to manage the risk of non-compliance.

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Appendix The Agency administers parts of other legislation for other government entities

Canadian Food Inspection Agency	
Health of Animals Act and Regulations *Food and Drugs Act* *Meat Inspection Act* and Regulations (includes poultry) *Feeds Act* and Regulations *Fertilizers Act* and Regulations *Plant Protection Act* and Regulations *Seeds Act* and Regulations *Canada Agricultural Products Act* and Regulations	Collect and review documents. Hold goods and refer to the Agency for release or examination decision. Collect Agency inspection fees (and monetary penalties).
Canadian Nuclear Safety Commission	
Nuclear Safety and Control Act • General Nuclear Safety and Control Regulations	Collect and inspect import licenses on the transshipment and in-transit movement of prescribed substances through Canada, that is, plutonium and deuterium.
Department of Canadian Heritage	
Cultural Property Export and Import Act	Issue export permits. Inspect and, where applicable, detain and refer goods to the Department of Canadian Heritage.
Department of Finance Canada	
Customs Tariff • Marking of Imported Goods Regulations	Certain goods imported into Canada are required to be marked with their country of origin. Customs examines these goods to ensure they are properly marked and detains those that are not.
Department of Foreign Affairs and International Trade	
Export and Import Permits Act	Verify and validate permits. Hold, inspect, and seize goods as required. Monitor goods controlled under tariff rate quotas to ensure proper classification as per the *Customs Tariff* and collect applicable duties.
United Nations Act	Detain shipments from countries with imposed trade sanctions.
World Trade Organization Agreement	Administer trade legislation.
North American Free Trade Agreement	
Department of Foreign Affairs and International Trade, Solicitor General Canada, and Royal Canadian Mounted Police	
Criminal Code *Export and Import Permits Act*	Validate permits, licenses, and customs documentation pertaining to the importation of these goods.
Department of Justice Canada	
Firearms Act	Determine admissibility of firearms, weapons, and devices.

Environment Canada	
Wild Animal and Plant Protection and Regulation of International and Interprovincial Trade Act	Validate certificates in respect of the Convention on International Trade in Endangered Species of Wild Fauna. Detain and refer goods to Environment Canada, as necessary.
Canadian Environmental Protection Act • Export and Import of Hazardous Wastes Regulations • Ozone-depleting Substances Regulations • Ozone-depleting Substances Products Regulations	Collect and verify documentation. When non-compliant, detain and refer shipment to Environment Canada.
Health Canada	
Controlled Drugs and Substances Act • Narcotic Control Regulations • Industrial Hemp Regulations	Collect and review import permits and return validated permits to Health Canada. Inspect goods, seize, or detain, and refer to Health Canada, when appropriate.
Food and Drugs Act • Food and Drug Regulations • Medical Devices Regulations • Veterinary Drugs • Processing and Distribution of Semen for Assisted Conception Regulations	Inspect, detain, and refer goods to Health Canada, when necessary. Ensure that required Health Canada information is shown on shipping containers of human semen.
Pest Control Products Act • Pest Control Products Regulations	Collect, review, and send validated import permits to Health Canada. Detain and refer suspect goods to Health Canada, when necessary.
Hazardous Products Act • Hazardous Products Regulations *Radiation Emitting Devices Act* • Cosmetics Regulations	Inspect goods. Detain and refer suspect shipments to Health Canada, when necessary.
Quarantine Act • Quarantine Regulations	Insure the presence of a medical or death certificate. Contact Health Canada, when necessary.
Department of Health Act • Human Pathogens Importation Regulations	Verify that the import permit attached to the shipment matches the permit presented for release. Collect and return the validated permit to Health Canada.
Industry Canada	
Consumer Packaging and Labelling Act *Textile Labelling Act* *Precious Metals Marking Act*	Advise Industry Canada when imported goods are suspected of violating one of the Acts.

Industry Canada and Royal Canadian Mounted Police	
Copyright Act *Trade-marks Act*	As directed by the courts, take all reasonable measures to detect and detain alleged infringing goods. At the request of the Royal Canadian Mounted Police, detain those goods (subsection 489(2) of the *Criminal Code*).
Natural Resources Canada	
Energy Efficiency Act and Regulations	Review, collect and forward import information to Natural Resources Canada. Detain goods with deficient import information.
Explosives Act • Explosives Regulations	Control and prohibit importation and exportation of explosives. Detain goods, where appropriate.
Statistics Canada	
Statistics Act	Provide Statistics Canada with import and export information.
Transport Canada	
Motor Vehicle Safety Act • Motor Vehicle Safety Regulations • Motor Vehicle Tire Safety Regulations	Ensure compliance with Canadian safety standards for all types of vehicles and tires entering Canada. Register United States qualifying vehicles for the Registrar of Imported Motor Vehicles.
Transportation of Dangerous Goods Act • Transportation of Dangerous Goods Regulations	Verify information on shipping documents and safety marks on containers and transport units. Forward information on suspected non-compliant shipments to Transport Canada.

Report of the Auditor General of Canada to the House of Commons—2001

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Chapter 9 Health Canada—A Proactive Approach to Good Health

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2001

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Chapter 9
Health Canada—A Proactive Approach to Good Health

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

9

Health Canada

A Proactive Approach to Good Health

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Health Canada
A Proactive Approach to Good Health

Main Points

9.1 We looked at how well population health projects were managed in three programs of Health Canada's Population and Public Health Branch. We found inconsistent management practices.

- The projects in the Canada Prenatal Nutrition Program were generally well managed.
- Many projects in the HIV/AIDS strategy were poorly managed, regardless of the dollar amount funded. For example, projects were approved despite concerns identified in the selection process, and the Branch failed to take timely action to remedy identified problems.
- Six large national projects in the Population Health Fund suffered from specific and significant problems. In particular, management did not have the proper authority to fund projects for prostate cancer research and enhanced fitness activities. Further, these projects were not subjected to the required selection process.

9.2 Choosing the "right" priorities at the outset is a critical step toward committing resources to areas that will yield the most benefit in improved population health. The Population and Public Health Branch has developed a framework or process for setting its priorities. However, the framework has never been approved and there is no plan or timetable for implementing it.

9.3 The evaluation of population health programs is generally weak. We found that the Department had made little progress in developing performance indicators for most programs. Such indicators are central to any meaningful evaluation exercise. Objective information on the effectiveness of the three programs that we looked at was limited. The information that Parliament receives on these programs does not provide a clear picture of the extent to which the $225 million spent on the programs has improved the health of Canadians.

Background and other observations

9.4 The federal government provides leadership and support for preventive health activities. These include health promotion, disease and injury prevention, health protection, and population health surveillance and assessment. Health Canada's Population and Public Health Branch has primary responsibility for supporting the federal initiatives.

9.5 The Population and Public Health Branch funds projects across the country that are delivered by other parties at the community level. Investment in these projects plays an important part in promoting quality of life, reducing costs to the health care system, and avoiding the loss of productivity due to ill health and injuries.

9.6 Our audit examined how the Branch sets priorities in choosing which population health programs to fund. We looked at the Branch's process for selecting, approving, monitoring, and evaluating a sample of projects in three specific programs: Canada Prenatal Nutrition Program; HIV/AIDS strategy; and the Population Health Fund. We also examined how the achievements of these three programs are measured and reported to Parliament.

9.7 The Branch does not have all the required evidence-based information that is critical for setting priorities. Sources of information include surveillance data and program evaluation. We found that the Branch lacks some of this information because it is either not co-ordinated or not available.

9.8 The Branch has a good process in place to manage its grant and contribution programs and ensure that public funds are managed properly. However, we found that management did not consistently follow its own management process.

9.9 In the fall of 2000, Health Canada's Internal Audit Directorate reported on an audit of the management of grants and contributions in the Population and Public Health Branch. One year later, management formally agreed to the recommendations and established an action plan. Timely implementation of the internal audit recommendations is crucial to correcting the identified weaknesses and improving the overall management of grant and contribution programs.

The Department has responded. Health Canada's responses to our recommendations are included in this chapter. The Department has responded positively to our recommendations and has agreed to take corrective action. In some instances, this action is already under way.

Introduction

The federal government plays an important role in preventive health activities

9.10 The federal government plays an important role in providing leadership and support for preventive health activities such as health promotion, disease and injury prevention, health protection, and population health surveillance and assessment. Its investment in these activities helps to promote quality of life, reduce costs to the health care system, and avoid loss of productivity due to ill health and injuries. Preventive health activities are estimated to be 6 to 45 times more effective than dealing with health problems after the fact. The federal government has established programs across the country to support these activities.

9.11 Health Canada provides leadership and support for programs that promote good health and protect Canadians against various health risks and the spread of disease. The provinces and territories are also responsible for providing many public health services. While each province and territory has a legislated public health function, at the national level there is no public health legislation that co-ordinates activities in the provinces and territories. Instead, co-ordination is exercised through joint activities involving various players, including the federal, provincial, and territorial ministers of health.

9.12 Health Canada's formal mandate is described in the *Department of Health Act*. The Department's powers lie in more than 20 acts that the Minister of Health administers, entirely or in part. The mandate, summarized in Health Canada's mission statement, is "to help the people of Canada maintain and improve their health." To achieve this mandate, Health Canada has an annual budget of $2.3 billion and employs 7,100 staff (see the Department's organization chart, Exhibit 9.1).

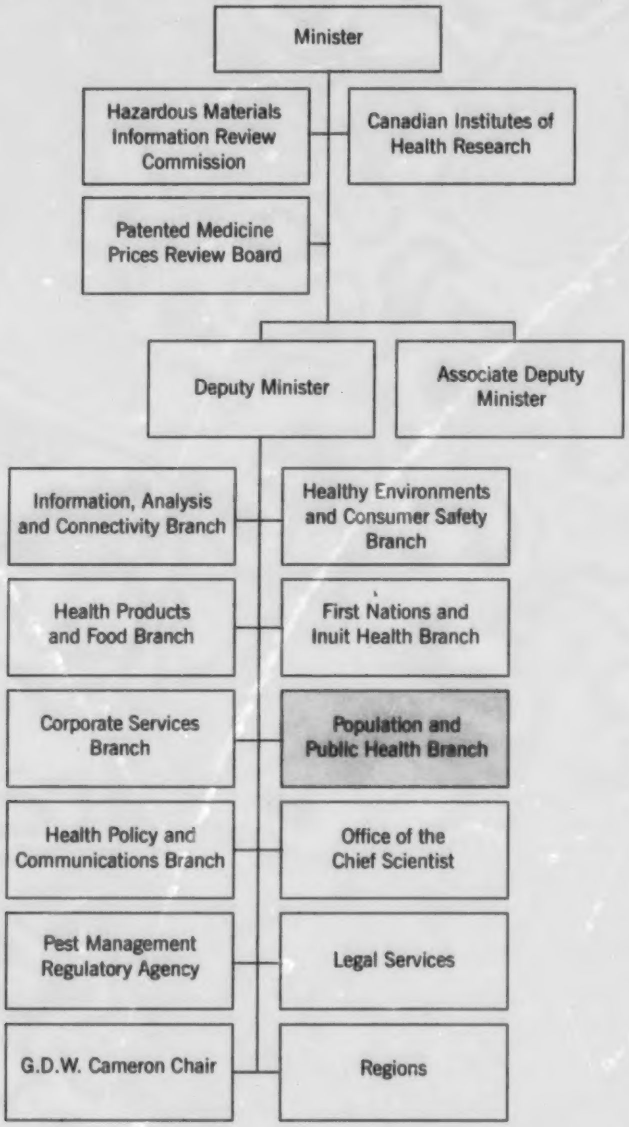
Responsibility for federal population health initiatives

9.13 The goal of Health Canada's Population and Public Health Branch is to maintain and improve the health of Canadians. One way to do this is by funding programs that help keep people healthy.

9.14 The Branch spent roughly $350 million in 2000–01, or about $11 for each Canadian, and employed about 1,200 people. This funding supports all of the activities of the Branch, including population health programming. The Branch operates from offices in Ottawa and in six regions—Atlantic, Quebec, Ontario and Nunavut, Manitoba and Saskatchewan, Alberta and Northwest Territories, and British Columbia and Yukon—and two national laboratories.

9.15 The Branch spent $225 million of its funding for 2000–01 on population health programming through transfer payments to support 12 grant and contribution programs. At 31 March 2000 it was managing around 1,800 grant and contribution agreements.

Exhibit 9.1 Health Canada's organization chart


Minister
Hazardous Materials Information Review Commission
Canadian Institutes of Health Research
Patented Medicine Prices Review Board
Deputy Minister
Associate Deputy Minister
Information, Analysis and Connectivity Branch
Healthy Environments and Consumer Safety Branch
Health Products and Food Branch
First Nations and Inuit Health Branch
Corporate Services Branch
Population and Public Health Branch
Health Policy and Communications Branch
Office of the Chief Scientist
Pest Management Regulatory Agency
Legal Services
G.D.W. Cameron Chair
Regions

▨ Our audit focussed on Health Canada's health activities managed by the Population and Public Health Branch.

Source: Health Canada

Canada was a pioneer in health promotion

9.16 A 1974 report by Health Canada, *A New Perspective on the Health of Canadians*, argued that better health could be achieved through a healthier lifestyle, better nutrition, and a healthier environment. It said that human biology, environment, lifestyle, and health care organizations were the four main elements that affect health. That report led the federal government to direct its policies toward improving the health of the population (for example, making seatbelt use mandatory). It focussed on issues related to individual lifestyle choices, such as exercise, diet, and smoking. In effect, the report acknowledged that contributing to the health of the population meant much more than merely supporting a health care system; it also meant promoting health in a number of non-medical ways.

9.17 In 1977, the federal, provincial, and territorial health ministers identified health promotion as a priority for joint action. They agreed that health promotion was legitimately a federal activity; it avoided interference with provincial and territorial responsibilities and complemented the health care system. Indeed, health promotion was seen as an opportunity to help the provinces and the federal government control and reduce the costs of the health care system.

9.18 The mid-1980s saw a growing concern about the limitations of health promotion efforts, which were largely directed at influencing the behaviour and lifestyles of individuals. It became apparent that other factors (or determinants) such as income, employment, social status, and housing also affect health. The growing emphasis on these and other non-medical determinants of health coincided with the 1986 report by Health Canada, *Achieving Health for All: A Framework for Health Promotion*.

9.19 In 1986, the first International Conference on Health Promotion was held in Ottawa. At this conference, the World Health Organization adopted the *Ottawa Charter for Health Promotion*. The Charter broadened the interpretation of health promotion to include the various determinants of health. It has since been translated into 50 languages and has become a guide for health promotion worldwide. The budget of the Health Promotion Directorate at Health Canada nearly tripled in 1987, as new national strategies were developed in the areas of drugs, tobacco, impaired driving, and AIDS. In the five years following the Ottawa Charter, health promotion continued to advance.

Health Canada adopts the population health approach

9.20 By the early 1990s, a population health approach began to replace the health promotion approach in many government and health policy circles. The approach expanded on the determinants or factors influencing health and included the effects of conditions in the social and economic environments beyond the health care system. It was recognized that population health programs would have to encompass all of the determinants of health (Exhibit 9.2), many of which are outside Health Canada's mandate.

9.21 Using the population health approach, Health Canada tries to establish programs that help maintain and improve the health of the entire population and reduce disparities in health among different population groups. It directs its programs toward "at risk" Canadians (for example, inactive adults, pregnant teens, Aboriginals, smokers, intravenous drug users, and street

Exhibit 9.2 What are the determinants of health?

Biology and genetic history. The genetic endowment of the individual, the functioning of various body systems, and the processes of development and age are fundamental determinants of health. Biological differences in sex and socially constructed gender influence health on an individual and population basis.

Culture. Some groups face additional health risks due to a socio-economic environment that is largely determined by dominant cultural values. This limits access to culturally appropriate health care and services.

Education. Health status improves with level of education, including self-ratings of positive health or indicators of poor health such as activity limitations or lost work days. Education increases opportunities for income and job security and equips people with a sense of control over life circumstances—key factors that influence health.

Employment and working conditions. Those with more control over their work circumstances and fewer stress-related demands on the job are healthier. Workplace hazards and injuries are significant causes of health problems. And unemployment is associated with poorer health.

Gender. Many health issues are a function of gender-based social status or roles. Women, for example are more vulnerable to gender-based sexual or physical violence, low income, and lone parenthood. Measures to address gender inequity and gender bias within and beyond the health system will improve population health.

Health services. Health services, particularly those designed to maintain and promote health and prevent disease, contribute to population health.

Healthy child development. The effect of prenatal and early childhood experiences on subsequent health, well-being, coping skills, and competence is very powerful.

Income and social status. This is the single most important determinant of health. Many studies show that health status improves at each step up the income and social hierarchy. As well, societies that are reasonably prosperous and have an equitable distribution of wealth have the healthiest populations, regardless of the amount they spend on health care.

Personal health practices and coping skills. Social environments that enable and support healthy choices and lifestyles, as well as people's knowledge, intentions, behaviours, and coping skills for dealing with life in healthy ways, are key influences on health.

Physical environments. Physical factors in the natural environment such as air, water and soil quality are key influences on health. Factors in the human built environment such as housing, workplace safety, community, and road design are also important influences.

Social environments. Social stability, recognition of diversity, safety, good working relationships, and cohesive communities provide a supportive society that reduces or avoids many potential risks to good health. Studies have shown that low availability of emotional support and low social participation have a negative impact on health and well-being.

Social support networks. Support from families, friends, and communities is associated with better health. Some experts conclude that the health effect of social relationships may be as important as established risk factors such as smoking, physical activity, obesity, and high blood pressure.

Source: Health Canada

youth). It often establishes these programs in collaboration with key partners in other government departments, provinces and territories, and the non-government sector so that all the determinants of health can be addressed, even those outside Health Canada's mandate. Exhibit 9.3 lists some of the key partners in the population health approach.

9.22 In July 2000, a reorganization of the Department created the Population and Public Health Branch to advance this approach. The Branch is now responsible for policies, programs, and systems related to prevention, health promotion, community action, disease surveillance, disease control, and the Department's emergency preparedness and response capacity. These responsibilities include most elements of the previous Health Promotion and Programs Branch, the former Laboratory Centre for Disease Control (responsible for national surveillance of diseases and injuries), and some responsibilities of the former Health Protection Branch. The inclusion of the Laboratory Centre for Disease Control brings together activities related to identifying and monitoring emerging and existing illnesses with health promotion and protection activities in the same unit of Health Canada.

Exhibit 9.3 Key partners in population health

Academics and researchers

The Canadian Institute for Advanced Research

Canadian Institute for Health Information

Canadian Population Health Initiative

Canadian Consortium for Health Promotion Research

Canadian Institutes of Health Research

Key stakeholders

Lobby groups

National organizations (for example, Canadian Cancer Society) and their provincial chapters

Provincial and municipal government entities

Community, regional, provincial, and territorial organizations

Project participants

Voluntary sector

Other government entities

Statistics Canada, Human Resources Development Canada, Veterans Affairs Canada

Interdepartmental Reference Group on Population Health

Federal–provincial–territorial advisory committees, such as the Advisory Committee on Population Health, the Advisory Committee on Health Services, and the Advisory Committee on Health Human Resources

Source: Health Canada

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Source: Health Canada

9.23 The Population and Public Health Branch currently funds 12 programs through grant and contribution agreements. Exhibit 9.4 lists these programs.

Exhibit 9.4 Population health programs funded through grant and contribution agreements

Aboriginal Head Start Program
Canada Prenatal Nutrition Program
Canadian Breast Cancer Initiative, phase 2
Canadian Diabetes Strategy
Centres of Excellence for Children's Well-Being
Community Action Program for Children
Falls Prevention Initiative (Health Canada and Veterans Affairs Canada)
Fetal Alcohol Syndrome/Fetal Alcohol Effects Strategic Project Fund
Hepatitis C Prevention and Support Research Program
HIV/AIDS strategy
Population Health Fund
Rural and Remote Health Innovations Initiative

Source: Health Canada

9.24 Surveillance and the information it generates can provide a means of identifying possible links between a disease and, for example, what we eat, where we live, or what our social status is. Surveillance activities link the scientific and technical knowledge of many institutions and disciplines to promote better health and to prevent and control communicable and chronic diseases and injuries. The surveillance work of the provinces, territories, and a variety of federal departments and non-government organizations generates data for input to the Branch's surveillance and control systems.

Focus of the audit

9.25 The purpose of our audit was to find out how the Branch decides which programs it should fund. We looked at a sample of projects under three of the Branch's 12 grant and contribution programs to examine how it selects, approves, monitors, and evaluates the projects it funds. Finally, we examined how the Branch has evaluated and reported the achievements of these three programs. More information on our audit objectives, scope, approach, and criteria can be found at the end of the chapter in About the Audit.

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Observations and Recommendations

Priority setting

Setting priorities is critical to making choices that optimize the health of Canadians

9.26 One of Health Canada's goals is to set its policy and branch priorities in a way that optimizes health outcomes for Canadians. Setting priorities means choosing which key health issues, such as cancer or diabetes, or which key health areas, such as obesity in adults or prenatal and child nutrition, should receive attention given that they all present identified risks to the health of Canadians. Setting priorities requires a process or structure for making rational, evidence-based decisions.

9.27 Such a process needs to consider all of the many health issues and the available interventions associated with them, such as educating school administrators on playground safety, and providing nutritional supplements to pregnant women. It also needs to take into account the health, social, political, and economic risks of not addressing an issue. In addition, it must recognize the many potential partners and sources of health information that provide input to decision making. Such a priority-setting process, if used on a cyclical basis, could serve as a framework for making decisions to either terminate or refocus existing programs or create new ones.

9.28 We expected that the Branch would have such a process that would enable it to set priorities on the basis of good, evidence-based information such as surveillance data and evaluations of population health programs. We expected that a decision to fund a program or not would be based on this priority-setting process. We found that although the Branch has recognized the need for such a process and recently developed one, the process has not received Health Canada's final approval and has not been implemented.

The Program Impact Assessment Project recognized the need for a priority-setting process

9.29 In 1999, Health Canada's Program Impact Assessment Project examined a number of the Department's programs and functions. It identified certain key requirements for success: a departmental culture that emphasizes performance and continuous improvement, tools for gathering evidence-based data, and a process for establishing priorities. The project included selected health issues from the Health Promotion and Programs Branch (now part of the Population and Public Health Branch). The issues were selected because they needed more attention, given their importance to the well-being of Canadians. In December 1999, the Departmental Executive Committee accepted a number of recommendations in the project's report.

9.30 Several recommendations were directed at the Health Promotion and Programs Branch. In particular, the report recommended that the Branch develop a priority-setting process by which it could compare activities and identify those on which it should focus its efforts. The report also recommended that the Branch develop the following:

- a means of assessing the relative importance of health issues and identifying the best interventions to deal with them;

- a body of evidence to decide which new programs to fund and whether to continue funding existing programs; and
- a future direction and possible options for its involvement in both new and existing programs.

9.31 The Program Impact Assessment Project examined seven selected health issues. Among these were mental health, fitness and active living, sexual and reproductive health, and injury prevention.

9.32 The project analyzed what these issues were costing the economy and determined that mental health was the costliest. Health Canada's subsequent analysis of the costs associated with depression support this conclusion (Exhibit 9.5). The project also noted that limited work was being done in the area of mental health. It recommended that the Branch begin the necessary planning and analysis to determine how best to address mental health concerns. Further, it recommended that the Health Promotion and Programs Branch take the lead in developing a proposal to present to the Departmental Executive Committee no later than April 2000. This proposal had not been presented at the time of our audit. However, work on mental health has begun. For example, the Branch is developing initiatives directed at children and adolescents, stress in the workplace, gender differences, and First Nations and Inuit people.

Exhibit 9.5 The cost of depression: $14.4 billion

A Health Canada study suggests that depression and distress cost Canadians at least $14.4 billion annually in treatment, medication, lost productivity, and premature death. The study also notes that promoting the mental health of Canadians would be a sound investment.

Source: Health Canada

Recently completed framework for setting priorities has not been approved

9.33 The Population and Public Health Branch's Wellness Framework provides a structure for decision-making. It provides a framework for the following:

- measuring the health of Canadians and identifying priority health issues;
- identifying the social, political, economic, and health risks, and the factors, conditions, and determinants of health that increase the likelihood of suffering from an illness related to the priority health issues;
- assessing available interventions for dealing with them; and
- developing a better process to set priorities.

9.34 Although a few decisions in the last few months have used the Wellness Framework (Exhibit 9.6), senior management has not yet approved it and neither a strategy nor a timeframe for implementing it has been established.

Exhibit 9.6 Wellness Framework in action

As directed by the Wellness Framework, the Population and Public Health Branch measured the health of Canadians.* It identified mental health, injury prevention, and healthy living as priority health issues. These findings are consistent with those of the Program Impact Assessment Project.

The Branch also identified community mobilization as a key intervention in tackling, from a federal perspective, issues of mental health, injury prevention, and healthy living. As a result, a strategy for community mobilization is currently being developed.

*For more details on measures of health, see Exhibit 9.7.

The Branch lacks some evidence-based information needed for setting priorities

9.35 A formal process for setting priorities requires good, evidence-based information. One key source of information on health issues is surveillance data, which are provided by the surveillance units now being integrated into the Branch. Surveillance data, along with data from other important sources, are key to measuring the health of Canadians. In a recent analysis of the health of Canadians, the Branch used the three measures shown in Exhibit 9.7. However, not all of the data needed to create two of the measures were available. They either had not been collected from the many partners that play a role in population health (federal, provincial, and other organizations) or were not organized appropriately. Therefore, the Branch had to use data from another country to measure the health of Canadians. In previous audits, we reported weaknesses in the efforts of the former Laboratory Centre for Disease Control to collect and co-ordinate surveillance data.

9.36 Information on what has worked and what has not, gathered through program evaluation, is also needed to set priorities properly. Evaluation can help determine what interventions are available, how effective they have been, and at what stage of life they produce the best health outcomes. Information is available from a number of sources, including university-sponsored population health research centres, provincial and international evaluations, and evaluations of Health Canada's own programs. However, we have identified several problems in Health Canada's evaluation activities that are similar to problems we have reported before.

Exhibit 9.7 Measuring the health of Canadians

The health of Canadians is established based on a series of aggregated measures of health:

- "Disability-adjusted life years" measures the sum of the years of life lost due to premature death and to disability.
- "Potential years of life lost" is the number of years of life lost because of premature death.
- "Health-adjusted life expectancy" is the expectation of equivalent years of good health that someone can expect to live.

Source: Health Canada and other sources

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Source: Health Canada and other sources

9.37 **Recommendation.** The Population and Public Health Branch should obtain approval from the Departmental Executive Committee for a formal priority-setting process. It should also develop a strategy and timetable for implementing that process.

Department's response. Agreed. The Departmental Executive Committee has approved the Branch priority-setting process. The Branch is now implementing this new priority-setting process.

9.38 **Recommendation.** The Population and Public Health Branch should ensure that it has the necessary processes to collect and co-ordinate the evidence-based information it needs to set priorities.

Department's response. Agreed. Evidence-based information is a major component of the priority-setting process. A joint developmental project is in place between Health Canada and Statistics Canada that provides the Department with the capacity to collect and co-ordinate evidence-based information. This project is focussed on obtaining a more objective assessment of the relative magnitude of different diseases, injuries, and risk factors in order to balance investments. This project has been presented to the Canadian Population Health Initiative fund, and has been unanimously supported by the Federal/Provincial/Territorial Advisory Committee on Population Health.

Managing funded projects

Projects funded through grant and contribution agreements

9.39 The government can pursue public policy objectives in a number of ways. It can use legislation and regulation; provide information and advice; deliver programs itself; or make transfer payments to individuals, organizations, and other levels of government.

9.40 Once the Population and Public Health Branch has identified its priorities for funding, it must decide what funding mechanism to use. The Branch delivers much of its population health programming through transfer payments to others. It has used $225 million of its budget to transfer funds to community groups, organizations, and individuals who have a direct link to the community that the government wishes to serve. As already noted (and shown in Exhibit 9.4), the Branch currently funds 12 population health programs through grant and contribution agreements.

9.41 Grant agreements transfer funds unconditionally to recipients who meet the terms of eligibility. Contribution agreements, however, have conditions attached to the funds: the recipient must not only meet the terms of eligibility but also the conditions included in the agreement. These conditions help the federal government ensure that its objectives will be achieved and that those who receive funds will manage them properly as they carry out their projects.

9.42 Our audit found that in all three programs, there is a well-established project management process and good program guidelines that clearly describe program objectives, priorities, and eligibility criteria (Exhibit 9.8). The management process helps ensure that funded projects respect the terms and conditions approved by the Treasury Board, the program guidelines, and financial authorities.

Exhibit 9.8 Program guidelines: Best practice

The three programs we audited had developed good program guidelines for program staff and potential applicants.

These guidelines clearly communicate the program objectives and priorities and the eligibility criteria. They help ensure that internal and external reviewers can assess projects and select those that are most suitable for the Branch to fund. They also help ensure consistency. The guidelines explain how to apply for funding and how projects are selected and approved. Providing these guidelines to potential applicants is one step in helping to ensure that funding is transparent.

Source: Health Canada

How we assessed the adequacy of project management

9.43 To assess how well the Branch manages its grant and contribution programs, we examined a sample of 38 projects from across Canada, under three of the 12 programs funded through grant and contribution agreements: the Canada Prenatal Nutrition Program; the HIV/AIDS strategy; and the Population Health Fund. Our sample comprised all projects over $2 million and 30 projects selected at random from the rest of the projects funded by the three programs.

9.44 Our observations in this section are drawn from those 38 projects. We are concerned about the significant number of our project reviews that identified problems in the project management process. In particular, we noted that the Branch did not subject high-value projects to a rigorous selection process, nor did it monitor those projects adequately. Our observations raise the question of whether the weaknesses we found in project management are broadly applicable across the Branch.

9.45 We selected these three programs because together they cover all stages of life (children and youth, adult, and later life), are administered nationally and regionally, use both grant and contribution agreements, and provide significant amounts of funding compared with the Branch's other population health programs. The combined annual budget of the three programs is roughly $70 million, or 35 percent of total spending on grants and contributions in the area of population health.

9.46 Our objective was to determine whether, in selecting and approving proposals for projects and subsequently monitoring and evaluating the projects, the Branch had met the terms and conditions approved by the Treasury Board and had adhered to its own program guidelines. We also wanted to determine whether payments had been made in accordance with the Treasury Board's Policy on Transfer Payments and the *Financial Administration Act*. These four sources of authority represent the standards for managing grant and contribution programs. The project management process described in Exhibit 9.9 reflects these standards.

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Exhibit 9.9 Key steps in the project management process

Project selection

1. Information sent to public, community solicited, and invitation to submit proposals sent.
2. Project proposal assessed by an internal assessor, external assessors, and an external advisory board.

Project approval

3. Project recommended for approval by the program or regional director and the Assistant Deputy Minister.
4. Project approved by the Minister of Health.
5. Grant or contribution agreement created.
6. Funds released to group.

Project monitoring

7. Project and financial monitoring.
8. Amendments or time extensions approved by the program or regional director.

Project evaluation

9. Project formally evaluated.
10. Agreement closed or, if an ongoing program, renewed.

Source: Health Canada

9.47 We expected that the Branch would have a process for ensuring that each project respects the terms and conditions approved by the Treasury Board, the program guidelines, and the financial authorities. We also expected that the process would be clear, openly communicated, and consistently applied. Finally, we expected that by following the process, the Branch could ensure that project proposals would be appropriately selected and properly approved; that projects would be adequately monitored and evaluated; and that financial authorities would be respected. As outlined in Exhibit 9.9, managing projects entails four steps: project selection, approval, monitoring, and evaluation.

9.48 Selecting projects for funding requires that the Branch communicate with potential applicants and other parties to inform them that funds are available for projects and invite them to submit proposals. It reviews project proposals to determine whether they are eligible for funding. External experts then assess the proposals and provide advice on the merits of the projects and their potential contribution to the program's objectives. Then an advisory committee uses the assessments to rank the proposals.

9.49 The project approval process requires Branch officials to recommend whether a project proposal should be funded. These recommendations are forwarded to the Minister of Health, who makes the final decision to fund them or not.

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9.50 The project selection process is important because it ensures that the Branch selects, from a number of proposals, those that contribute most to meeting program objectives. The process provides an opportunity for a range of organizations and individuals to submit proposals for funding. The project approval process requires that only projects subjected to the selection process be approved.

9.51 Project monitoring is the third key step in the management of grants and contributions. Monitoring means making regular contact to determine the status of the project, ensure that all required documents are submitted, and identify any problems as early as possible. Monitoring is also important for the Branch to ensure that recipients of contributions respect the terms and conditions of their agreements. Should the Branch identify any problems, it needs to take timely action to correct them by, for example, developing an action plan with the funding recipient, requesting an audit, or withholding funding.

9.52 Failure to monitor projects properly could mean that problems go unnoticed by the Branch. Problems include funds spent on activities other than those intended, or expenditures made that are ineligible for funding. Problems could mean that the project is no longer contributing to the program's objectives. As a steward of public funds, the Branch needs to take timely action when it finds problems.

9.53 Ongoing monitoring could show that an agreement covering a project may have to be amended because of changing circumstances. Grant and contribution agreements can be amended to provide additional funding or to extend a project's timeframe. The use of amendments needs to be limited to appropriate circumstances because amendments involve fewer controls. Funding provided through amendments is not subject to the same project selection process as funding through a new contribution agreement. Furthermore, staff who approve amendments are generally at a lower level than staff who approve new agreements. They also follow different administrative procedures.

9.54 Without proper guidance, amendments can be used as an informal way to extend a project's funding or timeline. They can also be used inconsistently and processed incorrectly.

9.55 Project evaluation, the fourth step, is a source of information that can be used to assess population health interventions. Contribution agreements require that each funding recipient complete an evaluation of the project. The evaluation is to identify how successfully the project has contributed to the objectives of the program. This information is used in deciding whether funding should be continued. Further, it can be used in an overall evaluation of the program.

9.56 The following paragraphs (9.57 to 9.88) briefly describe the three programs that we audited and present our observations on project management activities.

The Canada Prenatal Nutrition Program

9.57 At the 1990 United Nations World Summit for Children, the leaders of 71 countries made a commitment to invest in the well-being of children. In 1992, Canada responded to this challenge by developing the Community Action Program for Children (birth to six years). In 1994 the federal government announced the Canada Prenatal Nutrition Program (conception to six months), extending its support to the period before birth.

9.58 The Canada Prenatal Nutrition Program is a comprehensive, community-based program that supports pregnant women who live in conditions that threaten the healthy development of their babies. They include adolescents; women who abuse alcohol and other substances; those who live in violent or isolated situations or have no access to other services; refugees and recent immigrants; and off-reserve Metis, Inuit, and First Nations women. The program's aims are the following:

- improve the health of pregnant women (for example, by providing nutritional supplements and nutritional counselling);
- reduce the number of babies weighing under 2,500 grams at birth;
- promote breastfeeding; and
- increase access to services for pregnant teens and women (services such as support, education, referral, and counselling on lifestyle issues such as alcohol abuse, smoking, and family violence).

Exhibit 9.10 describes a project under this program.

Exhibit 9.10 A Canada Prenatal Nutrition project

The Healthy Baby and Me project provides education and support to young parents and parents-to-be. The project, administered by the Victorian Order of Nurses, also provides education, support, and skill development in prenatal health promotion, early parenting, breastfeeding, and infant feeding.

Source: Health Canada

9.59 Although the program had a number of projects running in 1994–95, the $12.3 million in funding provided in the 1997 Budget allowed for more community involvement. The program was renewed in 1998 and again in 2000, and its funding has now grown to $27.2 million for 2000–01. The program currently funds 277 projects in more than 680 communities across Canada. The Canada Prenatal Nutrition Program is delivered through Health Canada's regional offices.

9.60 **Canada Prenatal Nutrition Program projects are selected, approved, and monitored properly.** We audited 14 prenatal nutrition projects, all funded through contribution agreements. Many of them have operated for several years. We examined the project management process from the beginning of the program, but our observations focus on the process followed during the renewal in 2000. We observed improvements over previous years.

In general, the project proposals were subjected to an adequate selection and approval process and the projects were monitored adequately.

9.61 Canada Prenatal Nutrition projects are not subject to evaluation but are required to participate in the national data collection exercise organized by the Branch. In the files we reviewed, all projects had provided data on the projects and participants that included, for example, client history, participation rates, and project outputs such as birth weight and breastfeeding initiation. This data collection exercise provides performance information that can be used in evaluating the overall program (see Exhibit 9.11 for information on who is being served by the program).

Exhibit 9.11 Who participated in the Canada Prenatal Nutrition Program?

38% of participants were under 20 years old; 10% were under 17 years old.

49% were single, divorced, widowed, or separated.

58% had less than 12 years of education.

44% had a net monthly income of $1,000 or less.

46% smoked cigarettes.

13% experienced abuse.

Source: Health Canada

The HIV/AIDS strategy

9.62 The Population and Public Health Branch's HIV/AIDS strategy is part of the Canadian Strategy on HIV/AIDS, which was initiated in 1990 for a number of reasons:

- HIV/AIDS imposes a significant cost on society. Health Canada estimates that the roughly 50,000 people currently infected will create an economic burden of $27 billion during their lifetime.
- HIV/AIDS is a growing global epidemic.
- The demographics of the disease continue to change. Health Canada recognizes that HIV/AIDS is no longer an epidemic affecting predominantly gay men, given the sharp increase in infection rates among women, Aboriginal peoples, and intravenous drug users.
- Transmission of HIV/AIDS is entirely preventable.

9.63 Health Canada is the lead federal agency responsible for the Canadian Strategy on HIV/AIDS; as such, it receives $42.2 million or 98.6 percent of the Strategy's annual funding. The Population and Public Health Branch, through its HIV/AIDS strategy, manages $21 million of the funds allocated to Health Canada.

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9.64 The HIV/AIDS strategy is designed to fund community organizations that deliver projects using one of the following approaches (see Exhibit 9.12 for an example of an HIV/AIDS project):

- creating supportive environments;
- health promotion for people living with HIV/AIDS;
- prevention initiatives;
- strengthening community-based organizations;
- prevention, care, and treatment; and
- supporting national non-government organizations.

Exhibit 9.12 An HIV/AIDS strategy project

The Asian Community AIDS Services (ACAS) provides HIV/AIDS education, prevention, and support services to the East and Southeast Asian communities of the Greater Toronto Area. ACAS depends on volunteers and runs a volunteer training program that equips its staff to deliver services such as counselling and outreach.

Funding was provided to the ACAS to increase its skills and capacity to strengthen community resources, increase volunteer participation, and build better partnerships with other AIDS service organizations.

Source: Health Canada

9.65 **Little action was taken to address concerns about projects.** We reviewed files on 11 projects, eight of them administered nationally and three regionally. Included were three high-value projects (more than $2 million), discussed in Exhibit 9.13. We found that the Branch could not provide any documents detailing the selection process for any of the three high-value projects. We would expect that projects receiving this much funding would be managed more rigorously, and we consider it unacceptable that important documentation on these large contribution agreements was not available. In two of the projects, we found that the Branch had identified problems but had failed to take timely action to resolve them. The approval documents for the third project noted that the project received more funding than the reviewers had recommended.

9.66 In the eight national and regional files on projects under $2 million, we found five cases that were not subjected to an adequate selection process and yet the Branch recommended them for approval:

- We found no evidence that one of the projects had been subjected to any selection process.
- In two cases, the Branch specifically directed funding to the organizations. Funding was thus recommended and approved without any solicitation of proposals, internal or external review, or advisory committee review. One agreement was later amended to provide more funds.
- In another case, the internal reviewer suggested that the Branch reject the request for $84,000 in funding. Two of the five external assessments suggested approving $84,000 only if major revisions to the project were

made. Despite these negative assessments, the project was ultimately approved for an even larger amount, $130,000.

- We also noted a similar case in which one assessment suggested rejection, and two suggested approval only if there were major revisions to the project. It appears that the revisions were never made, but funding was recommended and approved.

Exhibit 9.13 Three high-value HIV/AIDS strategy projects that raise concern

Community AIDS Treatment Information Exchange (CATIE)

In 1998 the Population and Public Health Branch approved $8.75 million in funding for CATIE over five years. The project proposal was subjected to an internal and an external review process. The two external assessments of the proposal were not favourable and identified many significant concerns. Concerns were also raised about the project budget and the amount of funding requested. Yet the project was recommended for approval and approval was given. The concerns noted by the reviewers were not resolved before the project was approved. Moreover, the Branch approved the amount of funding requested.

Since funding began in 1993, the Branch has noted concerns about the project. In 1999, after six years of funding, the Branch began to take limited action to address some of these problems. It was not until two years later, in 2001, that the Branch finalized an audit of the project. Since the audit's completion, the Branch and the funding recipient have been working to negotiate an action plan. However, we are concerned that no serious action was taken until recently, and the Branch renewed funding for the project in 1998 in the amount of $1.75 million a year despite these concerns.

Canadian Public Health Association—Canadian HIV/AIDS Clearinghouse

This project was approved in 1998 for about $2.5 million over 33 months. We could not find the Branch's review assessment of the 1998 proposal. Without the documentation to support the review, we are unable to determine whether the Branch reviewer's recommendations were consistent with a recommendation that funding be approved.

The project had received funding from the Branch before 1998 under a previous agreement. An audit of that agreement and other agreements that the Branch had with the Canadian Public Health Association found non-compliance with the terms and conditions of the contribution agreements. The auditors reviewed approximately 10 percent of the financial transactions made, and recommended that the Branch recover $350,000. The Branch agreed to accept $100,000 after further analysis and subsequent discussions with the funding recipient.

Canadian AIDS Society

The project proposal for $2.8 million over 33 months was approved in 1998. We found limited evidence that the project had been approved and no documents from the selection process. Further, the evidence we received on the approval shows that the review assessment recommended that the project be funded for $150,000 less than in fact was later approved. No documents could be provided to support the rationale for the change in funding.

Source: Health Canada

9.64 The HIV/AIDS strategy is designed to fund community organizations that deliver projects using one of the following approaches (see Exhibit 9.12 for an example of an HIV/AIDS project):

- creating supportive environments;
- health promotion for people living with HIV/AIDS;
- prevention initiatives;
- strengthening community-based organizations;
- prevention, care, and treatment; and
- supporting national non-government organizations.

Exhibit 9.12 An HIV/AIDS strategy project

The Asian Community AIDS Services (ACAS) provides HIV/AIDS education, prevention, and support services to the East and Southeast Asian communities of the Greater Toronto Area. ACAS depends on volunteers and runs a volunteer training program that equips its staff to deliver services such as counselling and outreach.

Funding was provided to the ACAS to increase its skills and capacity to strengthen community resources, increase volunteer participation, and build better partnerships with other AIDS service organizations.

Source: Health Canada

9.65 **Little action was taken to address concerns about projects.** We reviewed files on 11 projects, eight of them administered nationally and three regionally. Included were three high-value projects (more than $2 million), discussed in Exhibit 9.13. We found that the Branch could not provide any documents detailing the selection process for any of the three high-value projects. We would expect that projects receiving this much funding would be managed more rigorously, and we consider it unacceptable that important documentation on these large contribution agreements was not available. In two of the projects, we found that the Branch had identified problems but had failed to take timely action to resolve them. The approval documents for the third project noted that the project received more funding than the reviewers had recommended.

9.66 In the eight national and regional files on projects under $2 million, we found five cases that were not subjected to an adequate selection process and yet the Branch recommended them for approval:

- We found no evidence that one of the projects had been subjected to any selection process.
- In two cases, the Branch specifically directed funding to the organizations. Funding was thus recommended and approved without any solicitation of proposals, internal or external review, or advisory committee review. One agreement was later amended to provide more funds.
- In another case, the internal reviewer suggested that the Branch reject the request for $84,000 in funding. Two of the five external assessments suggested approving $84,000 only if major revisions to the project were

made. Despite these negative assessments, the project was ultimately approved for an even larger amount, $130,000.

- We also noted a similar case in which one assessment suggested rejection, and two suggested approval only if there were major revisions to the project. It appears that the revisions were never made, but funding was recommended and approved.

Exhibit 9.13 Three high-value HIV/AIDS strategy projects that raise concern

Community AIDS Treatment Information Exchange (CATIE)

In 1998 the Population and Public Health Branch approved $8.75 million in funding for CATIE over five years. The project proposal was subjected to an internal and an external review process. The two external assessments of the proposal were not favourable and identified many significant concerns. Concerns were also raised about the project budget and the amount of funding requested. Yet the project was recommended for approval and approval was given. The concerns noted by the reviewers were not resolved before the project was approved. Moreover, the Branch approved the amount of funding requested.

Since funding began in 1993, the Branch has noted concerns about the project. In 1999, after six years of funding, the Branch began to take limited action to address some of these problems. It was not until two years later, in 2001, that the Branch finalized an audit of the project. Since the audit's completion, the Branch and the funding recipient have been working to negotiate an action plan. However, we are concerned that no serious action was taken until recently, and the Branch renewed funding for the project in 1998 in the amount of $1.75 million a year despite these concerns.

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Source: Health Canada

9.67 We found some evidence that the Branch monitored the eight projects under $2 million. However, we identified a number of weaknesses in its financial monitoring and control of payments:

- One project made an ongoing expenditure that was ineligible. The Branch warned the funding recipient that it would not fund the expenditure, but it continued to do so for 10 months.
- Three projects used program funding for expenditures that were ineligible.
- Four projects did not submit documents required by the conditions of the agreement, such as progress reports, audited financial statements, and final reports.
- One project's funding advance exceeded the maximum allowed under the Treasury Board Policy on Transfer Payments.

9.68 Many of the HIV/AIDS projects that we examined had no evaluations on file. When they did, the Branch often failed to use evaluation results to decide whether to renew or to terminate the project.

9.69 **Recommendation.** The Population and Public Health Branch should take corrective action to ensure that selection, approval, monitoring, and evaluation of all projects funded under its HIV/AIDS strategy follow the established processes.

Department's response. Agreed. A review of all current files has been launched. This review will identify remedial action, where required, and thus ensure that all projects funded under the HIV/AIDS strategy are in compliance with program guidelines and project management processes.

The Branch has established a grants and contributions monitoring capacity that will integrate with the work of the departmental quality assurance unit to ensure effective management of the Branch's grants and contributions.

As well, Health Canada's Grants and Contributions Steering Committee has developed a mandatory training program to be delivered to all departmental staff involved in the management and administration of departmental grants and contributions.

This training program has been piloted with some departmental staff in anticipation of rollout starting in early 2002.

Additionally, the Branch is reviewing the program guidelines for HIV/AIDS in order to ensure that they meet the requirements of the Treasury Board-approved terms and conditions. The Branch will also establish criteria for the funding, in exceptional circumstances, of non-solicited proposals.

The Population Health Fund

9.70 When the health promotion approach was replaced by the population health approach, the Population Health Fund was established to support projects that would increase community capacity to address the determinants that affect health. Projects can be directed at any of the three stages of life (children and youth, adults, and later life) and at any of the determinants of health (see Exhibit 9.14 for an example). Another purpose of the Fund is to give the Branch the flexibility to fund population health projects for which there is no specific program, perhaps because the issue is emerging or does not warrant specific programming.

Exhibit 9.14 A Population Health Fund project

Seniors and safe medication use: A cross-cultural education model

This was a project to better understand misuse of medication among Canadian seniors of different ethnic and cultural origins and to identify practical and effective ways to eliminate the problems. The project developed a culturally sensitive training package.

Through a needs assessment, focus groups, and a literature review, the project identified how culture, aging, and drug interactions can negatively affect health. Some interesting findings identified in the literature review were the following:

- In addition to prescribed medications, 28 to 40 percent of seniors also use herbal, homeopathic, and over-the-counter preparations.
- Between 19 and 28 percent of all hospitalizations of people over 50 years old are due to misuse of medication.

The culturally sensitive training package was used to train 91 health and social workers, managers, and community leaders, representing 80 organizations from across Canada.

Since the funding ended the recipient has continued to distribute the package to targeted communities.

Source: Health Canada

9.71 The Population Health Fund was established in 1997 and has an annual allocation of $14.1 million. It currently administers about 280 contribution agreements and 200 grant agreements.

9.72 The objectives of the Population Health Fund are the following:

- develop, implement, evaluate, and disseminate community-based models for applying the population health approach;
- increase the knowledge base for program and policy development on population health; and
- increase partnerships and develop intersectoral collaboration to address specific determinants of health or combinations of determinants.

9.73 The $14.1 billion annual budget of the Population Health Fund is split equally between national and regional projects. We were informed that most of the budget for national projects was committed to six national projects in the areas of prostate cancer research and fitness. Consequently, only about $1.7 million was available for other national projects. Only $5.5 million was available for regional projects because $1.5 million of the regional budget was used to fund the national fitness projects. This situation meant that far less money than envisioned was available to achieve the Fund's objectives.

9.74 **Ineligible projects were approved for funding.** The objectives of the Population Health Fund are clearly defined in the program's guidelines. When a project is funded whose objectives do not correspond with those of

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the program, funds are, in effect, being spent for purposes other than those approved for the program.

9.75 We reviewed 13 projects under the Population Health Fund, eight of them administered nationally and five regionally. Under the Population Health Fund guidelines (Exhibit 9.15), six of the national projects were not eligible for funding. Further, there was no evidence of communication with interested parties to invite project proposals; nor was there evidence of internal or external review or consultation with advisors. Yet all six of these projects were recommended and approved for funding, as discussed in Exhibit 9.16 and in the following paragraphs.

Exhibit 9.15 The Population Health Fund guidelines: Ineligible expenditures

The Population Health Fund guidelines clearly identify the following ineligible expenditures:

- ongoing organizational and overhead fees of an organization
- pure research, in any discipline
- profit-making activities
- provision of direct services that are part of other governments' jurisdictions
- survey studies, except those carried out to support objectives of the project (such as needs assessments).

Source: Health Canada

9.76 Our review of the three projects funded under the Prostate Cancer Research Initiative found that the Branch spent $15 million on projects, much of which was not eligible for funding under the program's guidelines. These projects are related to pure research and overhead fees that do not support the objectives of the program. This represents a violation of the program's terms and conditions. Further, the Branch paid one recipient $2 million even though it knew that the terms and conditions of the agreement had not been respected. We also found a disregard for the project management process, in particular, a failure to follow the project selection process. This too, violated the terms and conditions approved for the program. The approval of funding violated the program guidelines as well. These violations meant that not all potential applicants had an opportunity to apply for funding, and the funded projects were not compared with other potential projects to assess their relative merits.

9.77 Our review of the three projects funded under Enhanced Fitness Activities ($3.5 million over three years) found that they received funding for overhead fees that were not eligible under the Population Health Fund guidelines. This is another example of a violation of the program's terms and conditions. We also found a disregard for the project management process. The projects were not subjected to the selection process and, through the continued use of amendments, bypassed the project selection process again and continued to receive funds after the initial funding ended. We found no evidence that the $3.5 million in project funding went to the organizations that would contribute the most to the program's objectives.

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Exhibit 9.16 Six national Population Health Fund projects that raise concern

Vancouver Centre of Excellence in Prostate Cancer Research (VCEPCR)

The VCEPCR receives grant funding under two five-year agreements, each for $1 million annually. One project receives funding for prostate cancer research and the other, to develop the VCEPCR—a new entity created for this funding.

The Population and Public Health Branch did not solicit proposals to identify potential recipients for this funding. In fact, neither of the projects submitted a project proposal, and thus none was subjected to the selection process that would have included various assessments. This disregard for the selection process suggests that the Branch directed funding to the organization, which would violate the program's terms and conditions.

We found that the projects are clearly not eligible under the Population Health Fund guidelines because their activities and objectives do not correspond with those of the program. One project is for pure research and the other relates to funding to cover ongoing organizational and overhead fees; both violate the guidelines. Further, the organization itself is not an eligible organization. We also found that the five-year period of these grant agreements violates the program's terms and conditions, which state that grants must be limited to one year.

Also of concern is that the terms and conditions of the agreement clearly stated that no payments would be made under the prostate cancer research agreement until a peer review had been completed of the research proposals being considered by the VCEPCR. However, the Branch paid $2 million without this peer review.

Canadian Prostate Cancer Research Initiative (CPCRI)

Our review indicates that the CPCRI is also receiving funding through a grant of $1 million annually for five years for a prostate cancer research project. As with the VCEPCR projects, the Branch did not solicit proposals. Further, no proposal exists for the CPCRI project and it was not subjected to any assessment. Funding appears to have been directed to this organization, which would violate the program's terms and conditions.

Because the activities of this project are for pure research, it, too, is ineligible under the Population Health Fund guidelines. The five-year grant agreement also violates the terms and conditions.

ParticipACTION, Canadian Parks and Recreation Association, and Active Living Canada

Our random sample included three fitness projects for which some of the funding is for ongoing organizational and overhead fees. Such funding violates the Population Health Fund guidelines. Again, we found that the Branch had disregarded the project selection process. We note that the Branch received proposals for the three projects only after the funding had begun, and there was no internal or external assessment of the proposals or consultation with advisors.

These projects, initially funded in 1998 for one year, have been renewed annually by amending the agreements. The amendments represent almost $2.4 million in additional funding to the three projects. Amendments are not subject to the same selection process as new agreements, and can be authorized by staff at a lower level. We are concerned that the amendments to these three projects have been used to bypass the selection and approval processes. We are also concerned that the projects have not been evaluated. Essentially, the Branch has provided continuing funding without knowing whether or not the projects are achieving their objectives.

Source: Health Canada

9.78 We did not have similar concerns about the remaining seven projects, two of them national and five regional.

9.79 As was the case with the HIV/AIDS projects, many of the Population Health Fund projects that we examined had no evaluations on file. When they did, the Branch often failed to use evaluation results as part of the decisions to continue project funding.

9.80 **Recommendation.** The Population and Public Health Branch should ensure that the Population Health Fund is used to fund only projects that contribute to the program's objectives and meet its eligibility requirements.

Department's response. Agreed. The Branch has a management control framework in place that ensures that the Population Health Fund is used only to fund projects that meet program objectives and eligibility requirements. The Branch will reinforce the requirements of the framework to program staff as part of the department's training initiative.

9.81 **Recommendation.** The Population and Public Health Branch should ensure that it has proper authority to fund the six national projects. It should follow the established project management process.

Department's response. Agreed. Although Health Canada has approval to provide grants for research through its appropriations, it will clarify the grant authority for population health research. The Branch guidelines are being amended to clarify an inconsistency in wording between the guidelines and the Treasury Board-approved terms and conditions. A program directive, designed to clarify program authorities for fitness consistent with the terms and conditions, will be issued in December 2001.

9.82 **Recommendation.** The Population and Public Health Branch should strengthen its capacity to ensure that projects funded through contribution agreements are properly evaluated.

Department's response. Agreed. The Population and Public Health Branch has directed program staff to ensure that clear indicators of success are set out for all projects recommended for approval, and has reaffirmed the requirement for project evaluation, as set out in the revised standard contribution agreement template. Responsibility for strengthening program and project-level evaluation has been assigned to the Management Planning and Operations Directorate of the Branch. Additional steps include mandatory staff training and the revision of the appropriate processes and procedures in order to ensure compliance.

Program staff need additional guidance

9.83 Our audit identified several cases of non-compliance that occurred because staff lacked guidance on how to manage agreements. During our file review, for example, we asked who had the signing authority for approvals and amendments. We were told that there is no documented delegation of signing authority. Consequently, each program has developed its own generally accepted practices. However, the practices differ from program to program and are not always followed.

9.84 We observed that no departmental guidance exists on the use of amendments to contribution agreements. During our interviews, program staff expressed the need for such guidance. In the 14 prenatal nutrition projects we reviewed, we found that 156 amendments providing $8.8 million have been issued since the projects were initiated. Amendments were used in a number of different circumstances, for example, as part of the program renewal process in 1996, 1998, and 2000 (amendments totalling $6.3 million), as a means of bridge financing between an expired agreement and a new agreement, and as a means of providing additional funds to projects under existing agreements ($2.5 million). We identified six projects funded under agreements that were amended improperly, which means that funds were advanced in the absence of a valid contribution agreement.

9.85 **Recommendation.** Health Canada should ensure that staff are given adequate guidance to manage grant and contribution agreements, including the proper use of amendments.

Department's response. Agreed. Health Canada has launched a comprehensive initiative designed to improve the management of grants and contributions. This includes mandatory staff training and the establishment of a grants and contributions policy monitoring and quality assurance unit.

Consistent with the above, the Branch has established a grants and contributions accountability project that will ensure a timely and effective response to the recommendations of this audit, and other related initiatives.

The Population and Public Health Branch has issued direction to program staff on amendments to ensure they are properly used. A new amendment policy is now under consideration by the departmental Grants and Contributions Steering Committee.

Prompt action needed on internal audit recommendations

9.86 Within the last year, the Department carried out an internal audit of the Branch's grant and contribution programs as well as a study of the Department's framework for all grant and contribution programs. Although the scope of these two reviews was different from ours, we observed that some of their recommendations were related to issues that we included in this audit.

9.87 In the fall of 2000, the Internal Audit Directorate reported on its audit of grants and contributions managed by the Population and Public Health Branch. While that audit focussed on the adequacy of some key controls that we also identified and assessed, it did not look at the selection process or at whether evaluations of projects had been undertaken as the agreements required. A year after receiving the internal audit report, management formally accepted the recommendations and approved an action plan to implement them. It is important that there be no further delay in putting this action plan into effect.

9.88 In March 2001, Health Canada commissioned an outside consultant to review the Department's management framework for all grant and contribution programs. The review identified the need for a number of improvements and proposed an action plan. At the time of our audit, management at Health Canada had not yet approved that plan. Its timely implementation is crucial to correcting identified weaknesses.

Measuring and reporting results

Measuring program results is part of good program management

9.89 In this section of the chapter we report our observations on the measurement and reporting of results at the program level. Periodic program evaluation and ongoing measurement of performance tell management what has worked to produce desired results and what has not. The Branch needs this information for good program management; it provides a basis for planning and for setting priorities. In addition, it allows the Department to report publicly on the effectiveness of its programs.

9.90 We expected that the Department would have a plan for evaluating the programs of the Population and Public Health Branch and that it would carry out the evaluations in that plan. Further, we expected that the Branch, too, would evaluate its programs.

Few population health programs have been evaluated

9.91 We found that the Population and Public Health Branch does not have a formal evaluation plan for its 12 contribution programs. It has allocated few resources to program evaluation and has completed no evaluations.

9.92 However, Health Canada's Departmental Program Evaluation Division has a departmental evaluation plan that calls for evaluations of three population health programs: Canadian Strategy on HIV/AIDS (July 2001), Canada Prenatal Nutrition Program (October 2001), and Community Action Program for Children (2003). These are under way. In addition, the Department has committed to providing the Treasury Board with an evaluation of population health programming by 2004.

9.93 Funding for the 1998 renewal of the Canadian Strategy on HIV/AIDS was approved with a condition that a three-year report on the Strategy's success be submitted to Cabinet no later than July 2001. This evaluation was under way at the time of our audit, but the Department had not yet set a completion date. When the Canada Prenatal Nutrition Program was established in 1994–95, the Department committed to conducting an evaluation after four years. In part because of lack of data, the evaluation was delayed. Since then, however, the Branch has collected some national data on the program. The evaluation that was due in October 2001 is now scheduled for completion in March 2002, eight years after the program's inception. No evaluation of the Population Health Fund is scheduled.

9.94 We noted that the prenatal nutrition program has collected data on individual projects through questionnaires completed by the funding recipients and by participants in the projects. These data have been rolled up nationally to provide information about infant and maternal health outcomes across Canada that will be valuable to the current evaluation. However, as noted earlier, we are concerned that many HIV/AIDS strategy and Population Health Fund projects did not have evaluations on file. Without evaluations at the project level, potentially important data are not available for evaluations at the program level.

9.95 Some regional offices have initiated studies of aspects of population health programs in their areas. However, these studies are not part of any consolidated Branch-wide effort, making it difficult to understand the value of interventions on a national basis.

The Branch needs to develop indicators for measuring performance

9.96 While evaluation is carried out periodically, performance measurement is an ongoing activity that measures results. Performance measurement helps managers know whether a program is moving in the right direction. Central to measuring performance are performance indicators, which specify the terms in which performance or success will be measured. We expected that the Department would be using or developing performance indicators.

9.97 We found that the Population and Public Health Branch twice began to develop a framework for better management of its performance, but it has not yet completed one. Nor has it made much progress in developing performance indicators for most population health programs.

9.98 In late 1998, Health Canada developed a population health performance and accountability framework that outlined objectives, key expected results, performance indicators, a performance measurement strategy, and responsibility for ensuring accountability. This performance and accountability framework was general in nature and applied to specific population groups. It was never implemented.

9.99 The 1999 Budget directed $43 million over three years to Health Canada for the Federal Accountability Initiative to improve the Department's reporting to Canadians on its performance. The Information, Analysis and Connectivity Branch of the Department is leading this initiative, which provides funding to Health Canada's branches. The Population and Public Health Branch received almost $1.2 million, which it matched from its own budget, to develop an integrated performance measurement and reporting framework. It has not yet finalized the framework, although Branch management has committed to do so by the end of 2002.

9.100 The Branch has made little progress in finalizing performance indicators for population health programs. It has outlined indicators for 12 of 27 program areas but in most cases has not identified data sources or specified targets. Of the programs we audited, only the Canada Prenatal Nutrition Program shows some progress. It has developed project and client questionnaires to capture data on infant and maternal health outcomes and breastfeeding initiation. It has reported these data nationally and regionally since 1998. Neither the HIV/AIDS strategy nor the Population Health Fund has finished developing performance indicators.

9.101 With neither program evaluations nor performance indicators, the Branch cannot say to what extent its programs have helped improve the health of Canadians.

The reporting of results to Parliament needs to improve

9.102 The Department reports to Parliament only limited information on the effectiveness of its population health programs. We reviewed its reports on plans and priorities and its performance reports for the last three years and found few references to the effectiveness of population health programs.

9.103 **Recommendation.** Health Canada and its Population and Public Health Branch should strengthen the evaluation of the population health programs.

Department's response. Agreed. The Population and Public Health Branch will work with the Departmental Program Evaluation Division (DPED) to implement the Treasury Board's new Evaluation Policy. As part of this initiative, the Population and Public Health Branch and DPED will immediately undertake to invest in developing the required capacity, including specialized human resources, and the development and implementation of a multi-year evaluation plan for population health programs. Some evaluations of population health programs are currently under way.

9.104 **Recommendation.** The Population and Public Health Branch should finalize performance indicators for its population health programs.

Department's response. Agreed. A performance measurement project is under way in the Branch, as part of a department-wide initiative to improve reporting to Parliament and citizens on the results of Health Canada's programs. The selection of program performance indicators, as well as the identification of data sources for these indicators and a measurement and reporting strategy, are included as part of the performance measurement framework.

9.105 **Recommendation.** Health Canada should ensure that the results of its population health programs are reported to Parliament in its performance report.

Department's response. Agreed. Health Canada will report on results of population health programs in its performance report for the period ending March 2002.

Conclusion

9.106 Health Canada has a responsibility to help the people of Canada maintain and improve their health. As one means to achieve this, it provides leadership and support for preventive health activities like health promotion, disease and injury prevention, health protection, and population health surveillance and assessment. The Population and Public Health Branch has primary responsibility for federal population health initiatives, which it delivers largely through grant and contribution programs.

9.107 The Population and Public Health Branch has no formal basis for determining what, where, and how population health activities should be undertaken. The Branch recently developed a framework for setting priorities. However, the framework has not been approved, nor is there a strategy or timetable for implementing it. Such a framework would provide a rationale for terminating or refocussing existing programs and creating new programs.

9.108 In all three programs we examined, we found a well-established project management process and clear program guidelines. If followed, both help ensure that projects respect the terms and conditions approved for the program by the Treasury Board, the program guidelines, and the applicable financial authorities.

9.109 In the Canada Prenatal Nutrition Program, we found that the projects we reviewed had generally been managed well. We did point out, however, that program staff were frequently using amendments to agreements without proper guidance in order to continue project funding.

9.110 In the two other programs, we observed many situations where management failed to follow established processes. In particular, we found that several projects were funded under the HIV/AIDS strategy and six national projects under the Population Health Fund without proper adherence to important steps in the selection process. In these cases, there was no solicitation of proposals from other potential applicants. Also, proposal assessments either had not been completed or were weak.

9.111 In our review of the HIV/AIDS strategy, we noted that files on two high-value projects lacked important documents. Further, the Branch had failed to resolve a number of concerns that were raised about projects before it funded them. Several projects under $2 million were not subjected to an adequate selection process and yet the Branch recommended that they be approved for funding. Consequently, the Branch has no assurance that the best projects were funded or that those projects are being properly managed. As well, we concluded that the Branch did not exercise proper stewardship over public funds to these projects.

9.112 In the Population Heath Fund, we noted that funds had been used to support six large national projects that were not eligible under the program's guidelines. Two of these six projects involve pure research, which is clearly not one of the program's objectives. Further, they do not support the Branch's responsibility to promote health across the population. Management had not ensured that it had the proper authority to fund the six projects, in the areas of prostate cancer research and fitness. The failure to respect the established project management process resulted in funding decisions that were arbitrary or inappropriate.

9.113 Clearly there are a variety of factors, including political, national, and international pressures, that impact on how grants and contributions are used to fund projects. However, we identified a number of projects that management had recommended for approval and approved without having followed its own project management process. We believe that this is unacceptable.

9.114 The Branch needs to improve its measurement and reporting of results of grant and contribution programs. None of the programs we audited had been evaluated to determine whether they had achieved their objectives, whether they were still relevant, or whether alternatives should be considered. Such evaluations would examine the difficult questions of the programs' rationales and their effectiveness. Answers to these questions are important if Parliament is to know whether these programs are valuable or not, and to what extent they have an impact on the health of Canadians.

About the Audit

Objectives

The objectives of the audit were to determine the following:

- whether there is a rational basis for determining what, where, and how population health activities should be undertaken;
- based on the Branch's project management process, whether its management of grant and contribution agreements is adequate; and
- whether the Branch adequately measures and reports the results achieved by population health programs.

Scope and approach

Our audit focussed on Health Canada's population health activities managed by the Population and Public Health Branch. We examined how the Branch establishes program priorities. We examined the project management of three grant and contribution programs used to fund population health activities. Further, we looked at how program achievements are evaluated and reported.

We interviewed departmental staff and several provincial officials involved in public health. We reviewed documentation, including legislation, corporate and branch documents, grant and contribution agreement files, planning documents, studies, internal audit reports, and information from a variety of Internet Web sites.

Our audit included a detailed examination of files on 38 projects from the Canada Prenatal Nutrition Program, the HIV/AIDS strategy, and the Population Health Fund. We examined whether the 38 projects were selected, approved, and subsequently monitored and evaluated according to the terms and conditions approved by the Treasury Board and the program guidelines developed by the Population and Public Health Branch. We also examined whether payments were made in accordance with the Treasury Board's Policy on Transfer Payments and the *Financial Administration Act*.

For each project, we looked for evidence that Health Canada had done the following:

- followed the established selection process, including
  - communicating with stakeholders to inform them that funds were available for projects
  - completing internal assessments of proposals as part of the selection process (to determine the eligibility of the organization and project; the capacity of the project to achieve the program's objectives and respect program priorities; and the eligibility of proposed expenditures)
  - completing external assessments of proposals and consulting with advisors (to determine the acceptability of projects and their funding levels and the relative priority of projects)
- followed the approval process (to ensure that projects were recommended for approval appropriately and that funding was approved by the appropriate authority)
- followed the project monitoring process (to ensure that the project remained in compliance with the terms and conditions of the contribution agreement; that the organization had the capacity to continue to achieve program objectives; that financial requirements were respected; and that actual expenditures were eligible)
- followed the amendment process (to ensure that amendments were used appropriately)
- followed the project evaluation process (to ensure that evaluations were completed, used in project renewals, and used in evaluation of programs).

Criteria

We expected that

- the Population and Public Health Branch's population health activities would be based on a rational framework for setting priorities
- the objectives of the grant and contribution programs would be clearly stated. Program criteria would be consistent with program objectives and the requirements of central agencies
- appropriate procedures for selecting projects would be clearly documented and communicated and consistently applied
- the Population and Public Health Branch would appropriately monitor approved grant and contribution agreements and report the results
- financial and management control of project funding would comply with relevant government policies and legislation.

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Report of the Auditor General of Canada to the House of Commons—2001

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The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

10

National Defence

In-Service Equipment

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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National Defence
In-Service Equipment

Main Points

10.1 The Canadian Forces spend about 20 percent of an $11.2 billion defence budget to manage, repair, and maintain military equipment. About $1.5 billion of this pays for the purchase of spare parts, maintenance, and repairs; about $900 million represents the pay of roughly 15,000 military personnel who manage and support in-service equipment.

10.2 Officials told us that management had decided to reduce the readiness levels of Canadian Forces equipment because of budget constraints and because the international situation no longer warranted high levels of readiness. Although officials said that the reductions had been carefully controlled, we found the following:

- National Defence has not established an adequate system that defines standards and goals for equipment readiness or availability, and there is no unified reporting system to collect this information.
- The Canadian Forces do not complete, file, or analyze post-exercise reports on 60 percent of the exercises they conduct, nor are post-operation reports always completed, filed, and analyzed. This makes it hard to assess both the causes and the impacts of equipment availability problems.
- Data needed to track and manage equipment availability are incomplete, often inaccurate, and sometimes not compiled in the same way. This makes it very difficult—if not impossible—for management to know the true state of its major equipment platforms.

10.3 The Department has too few maintenance personnel to fully staff operational units and major maintenance depots. Equally serious, about 15 percent of its maintenance people lack the qualifications their ranks require. In addition, maintenance personnel lack much of the specialty training required in their units.

10.4 Nevertheless, the Department has been able to operate naval vessels at a more or less constant level of activity since 1995. The Army has been able to meet the increased demands of peacekeeping and peace support, almost doubling the use of its wheeled combat vehicles. The Air Force, however, has reduced its activities substantially, due mainly to budget reductions and the declining need for high readiness.

10.5 The armed services have set a variety of standards and goals for equipment availability, but the degree to which they are being met is not clear. We could not determine how well the Navy maintains its warships because the data were not available. The Army has kept the serviceability of equipment in its operational units at close to an informal minimum standard of 75 percent, with no noticeable decline in availability. The Air Force has experienced low levels of equipment availability in the last five years, and availability of the Hercules and the Aurora fleets continues to decline.

10.6 The supply system can normally deliver parts within a 30-day deadline, meets about half of 7- to 14-day deadlines, but rarely meets urgent requirements. Its level of service has been constant since 1995. Except in a few specific cases, our audit did not establish a correlation between the availability of spare parts and the availability of equipment to support operations.

10.7 In operations conducted to date, equipment availability has been adequate overall. In certain fleets, however, a frequent, recurring lack of serviceable equipment has hampered military training and operations. Departmental initiatives are under way, such as the Materiel Acquisition and Support Information System (MASIS) and Canadian Forces Supply System Upgrade (CFSSU); officials expect them to improve the management of in-service equipment and contribute to enhancing equipment serviceability and availability.

The Department has responded. Overall, National Defence agreed with our findings. The Department told us it would take steps to improve readiness information systems and data quality. It also said it was working to close gaps in training and to improve the supply of spare parts to deployed units.

Introduction

Budget limitations have contributed to reduced readiness goals

10.8 In his February 2001 Report to the House of Commons, Reflections on a Decade of Serving Parliament, the outgoing Auditor General wrote that Defence program "affordability has been a major problem since the middle of the 1990s." The "multi-purpose, combat-capable" force called for in the federal government's 1994 Defence White Paper was not fully defined. As a result, with successive budget cuts every service and branch of the Canadian Forces has tried to perpetuate itself in an ever-leaner version. In spite of recent corrective measures, the effects of trying to maintain a force too large for its budget will last for several years.

10.9 National Defence can change the readiness of military units in order to stay within its budget. The challenge for the Department is to translate policy into a force structure within fixed budget limits.

10.10 In 1999, the Navy became the first service to apply a strict interpretation of Canada's minimum defence requirements to its operations and activities. It acknowledged that previous levels of readiness were no longer justified, given current global and political conditions, and were not sustainable at present funding levels. The Air Force carried out a similar exercise in May 2000, and the Army in April 2001. The Army's exercise aims to produce a sustainable Army by 2004.

10.11 In spite of the government's decision to invest around $2.4 billion more in defence from 1999–2000 to 2001–02, departmental plans indicate a budget shortage of $1.3 billion for 2001–02. The Department is reviewing its budget for the coming years. National Defence spent about 19 percent of its 2000–01 budget on new capital assets, including equipment. The Department continues to increase capital spending toward an interim goal of 21 percent in 2004–05 and an ultimate goal of 23 percent.

10.12 Our 1998 Report chapter, National Defence—Equipping and Modernizing the Canadian Forces, reported that to meet its estimated needs for new equipment over the next five years, the Department would have to almost double its planned spending on equipment, from $6.5 billion to $11 billion. In response to that chapter, departmental officials said that "hard choices may have to be made." Force reductions and reduced military readiness were possibilities. For example, a June 1998 Air Force study concluded that the strategic capital plan did not provide for enough money to modernize all the core combat capabilities of the Air Force. It cited the upgrading of the CF–18 Hornet and the Aurora for immediate attention.

10.13 Recent initiatives have not generated the savings the Department had forecast. Our December 2000 follow-up on defence support productivity found that the Department had yet to complete the efforts begun in 1994 to transform itself into a more entrepreneurial organization. Because of massive changes in the support organization and processes, we could no longer measure productivity; nor could the base and wing support managers tell us whether they were more or less productive than in 1996.

10.14 Our 1999 audit of the federal government's alternative service delivery arrangements noted unconfirmed estimates by National Defence that its use of such arrangements had saved it about $68 million per year. However, the Department had projected in 1996 that annual savings would reach $200 million by 1999. Based on estimated results, it has revised this projection to $175 million a year by 2004.

10.15 Managing the in-service equipment fleets of National Defence is complex and expensive. In 2000–01, the Department spent about 20 percent of its $11.5 billion expenditure to manage, repair, and maintain military equipment. About $1.3 billion of that was for spare parts, maintenance, and repairs; about $0.9 billion covered salaries and benefits of roughly 15,000 military employees who manage and support in-service equipment. National Defence also spends about $2 billion of its capital funds each year on new equipment and major upgrades of existing equipment.

10.16 The Department must ensure that it employs the right number of people with the qualifications needed to keep its fleets of equipment in service. It also contracts out some of its maintenance and support work to ensure that its fleets are available for operations. Spare parts must also be available and delivered when they are needed to ensure that the maintenance workers and technicians can keep fleets operating.

Focus of the audit

10.17 Our audit focussed on the adequacy of personnel and spare parts for equipment maintenance. We used available information to analyze trends and determine whether maintenance has kept equipment available for the day-to-day operations of the Canadian Forces. We also assessed the impact of maintenance problems on collective training and exercises and on international operations. Further details on the audit are in About the Audit at the end of the chapter.

Observations

Equipment status and trends

10.18 The objective of the equipment support functions of the Canadian Forces and the roughly 15,000 military personnel in maintenance trades is to keep the equipment of the Canadian Forces ready for use. We examined data on the ships, vehicles, and aircraft that the Canadian Forces consider most important to their military operations. We looked at three trends in these important weapons platforms:

- **Activity rates.** The rate of activity is important when evaluating the success of equipment support functions in reaching availability objectives. If equipment is seldom used, having it ready much of the time is not a major accomplishment. However, low activity rates could indicate that equipment is not available for use because of inefficient support.

- **Ability to maintain equipment in service**. Our goal was to establish how successful Defence support functions were in meeting their equipment availability objectives. We use availability and serviceability interchangeably in this chapter, unless otherwise specified. These terms are used to indicate the ability of equipment to perform its intended functions.
- **Level of maintenance effort.** We were concerned that the aging of equipment might be rapidly increasing the maintenance effort needed to keep it available. We therefore examined trends in maintenance levels.

Except for the Air Force, activity rates have been maintained

10.19 To determine activity rates of the equipment fleets we selected for audit, we used sea days as the measure of naval activity, kilometres put on army vehicles, and yearly flying hours for aircraft (flying hours are measured from the time an aircraft starts to move under its own power until it stops).

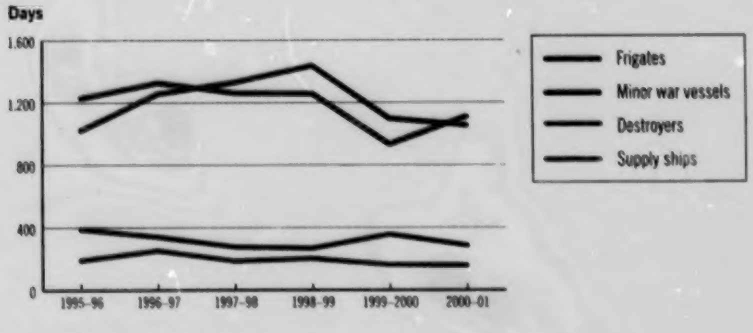
10.20 **Navy.** We reviewed the annual days at sea by class of ship, and found for the period 1995–96 to 2000–01 that activity rates were relatively constant (Exhibit 10.1).

10.21 **Army.** Data from 1989 to 1998 were available to assess activity rates of army vehicles. In that period, the Army maintained the activity rates of its key vehicles and increased the use of some. Since 1996, operations have increased the overall use of two key armoured vehicles—the Bison and the Grizzly. In 1996, for example, Grizzly vehicles in Bosnia–Herzegovina averaged about three times the kilometres averaged in the Grizzly fleet as a whole. The Coyote's use has increased since 1996 as the vehicles have been delivered (Exhibit 10.2).

10.22 Use of the medium logistic vehicle wheeled (MLVW) declined from 1989 to 1995 as the heavy logistic vehicle wheeled (HLVW) was introduced (Exhibit 10.3).

10.23 Overall, the Army maintained or increased the use of its key vehicles during the period we studied.

Exhibit 10.1 Annual days at sea, by class of ship



Source: Director General, Maritime Force Development

10.24 Air Force. Air Force activity has declined significantly since 1990, and steadily since 1995 (Exhibit 10.4). Budget reductions and lower requirements for readiness appear to be the main reasons, and not maintenance problems.

Navy ships

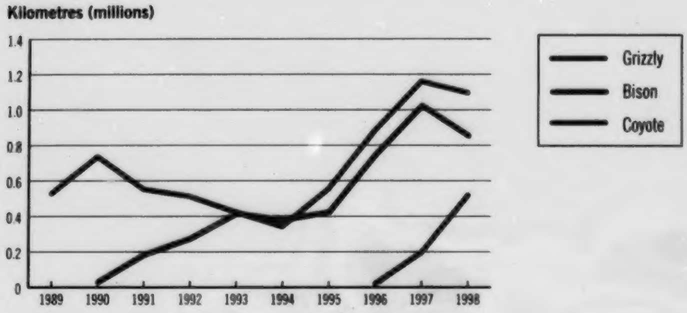
Destroyer

Iroquois class destroyer. A helicopter-carrying, command and area air defence vessel with anti-submarine warfare capabilities. These vessels support an embarked senior officer in tactical command of a national or allied task group of ships and aircraft. The two naval task groups located on East and West coasts are built around these ships. Quantity: 4. Date of purchase: 1970 and 1971.

Frigate

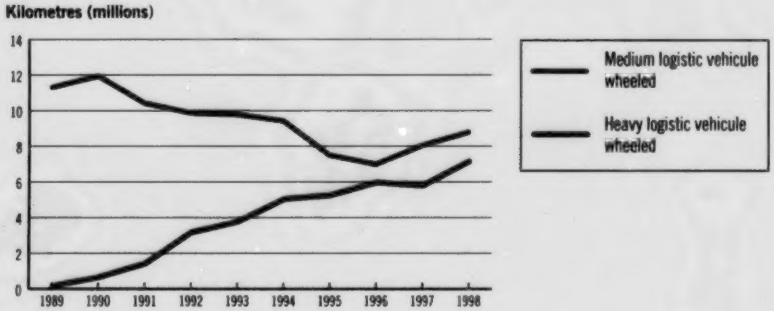
Halifax class frigate. Canadian designed helicopter-carrying vessel. It combines traditional anti-submarine capabilities with systems to deal with surface and air threats. It is the work horse of the naval task groups. Quantity: 12. Date of purchase: 1992 to 1996.

Exhibit 10.2 Bison, Coyote, and Grizzly—Total kilometres driven



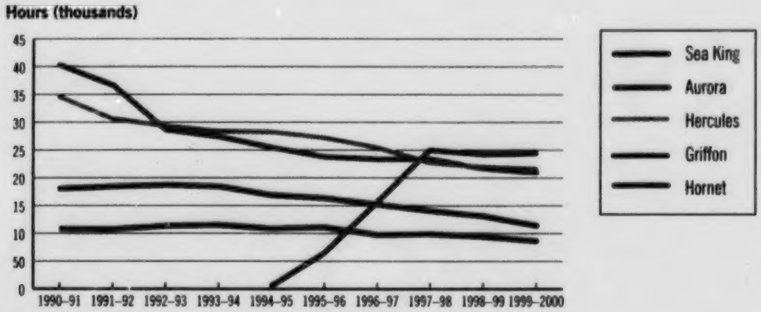
Source: Performa—Equipment

Exhibit 10.3 MLVW and HLVW—Total kilometres driven



Source: Performa—Equipment

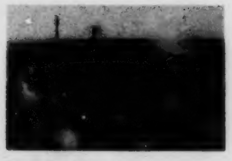
Exhibit 10.4 Annual flying hours, by Air Force fleet



Source: Performa—Air

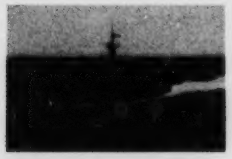
Problems in keeping equipment in use

Navy ships



Supply ship

Protecteur class operational support ship. Supply ships replenish naval task groups at sea with food, munitions, fuel, spare parts, and other supplies. Their large capacity and extended range enable naval task groups to stay at sea longer and go farther. Quantity: 2. Date of purchase: 1968 and 1969.



Maritime Coastal Defence Vessel

Kingston class ship. Minor war vessel, whose primary mission is coastal surveillance. It is equipped to carry various payloads: minesweeping, route survey, or bottom object inspection. It offers an economical alternative to major surface ships for routine coastal patrol. The vessel's crew is composed primarily of naval reservists; however, two Regular Force technicians augment each of the twelve crews. Quantity: 12. Date of purchase: 1995 to 1998.

10.25 We expected that each armed service would have goals or standards for equipment availability based on its operational and training needs. We also expected that each service would monitor its maintenance efforts to ensure that equipment was neither overmaintained nor undermaintained.

10.26 **Navy.** While the Navy has the raw data, it does not compile statistics on the availability of its key systems. Major deficiencies in systems on board ships are reported as they occur, through the operational deficiency reporting system. We focussed on deficiencies that affected combat capability, safety, or immediate operations.

10.27 The annual rate of operational deficiencies per sea day was significantly higher on the East coast from 1997–98 to 1999–2000 than on the West coast—indeed, more than twice as high in 1999–2000. Navy officials indicated that differences in operations, climate, weather, and sea states are some of the factors that could contribute to the disparity between coasts. On average, the time it took to correct the deficiencies decreased during that period, on both coasts. Officials on the West coast attributed the decrease there to a major change in the focus of operations. Ships have had to perform more high-profile missions, making the timeliness of repairs more critical.

10.28 **Army.** Overall, the Army has kept equipment readiness levels at or near informal goals most of the time, although in some brigades the HLVW and Bison show some decline. Generally, equipment has been available for operations at more-or-less-constant levels since 1989.

10.29 At the brigade level, serviceability has fluctuated from month to month since 1995. Most of the time, it met an informal standard of 75 percent, the lowest brigade goal. However, we did note a significant decrease—between 6 and 15 percent—in the serviceability of the HLVW in brigades. At 5 Canadian Mechanized Brigade Group we found that the serviceability of the Bison had decreased 27 percent.

10.30 We also reviewed the serviceability of vehicles used in Bosnia–Herzegovina, Kosovo, and Eritrea and found no significant trends. The Department explained that serviceability rates below 90 percent, the informal goal, were likely accounted for by inspection schedules, problems in getting spare parts for the HLVW, and failures of parts in the MLVW, Coyote, Bison, and Grizzly fleets.

10.31 The Department calculates an annual rate of vehicle availability to show the percentage of time that vehicles were available and not down for maintenance. This operational availability rate is calculated for the vehicles in service that have had some maintenance at some time during the year. Given that data for 1999 and 2000 were incomplete, we looked at data from 1989 to 1998.

10.32 During that period, operational availability of both the HLVW and the MLVW fleets stayed above 80 percent, although the MLVW's availability was lower than in previous years. The Grizzly fleet's availability fluctuated, remaining below 80 percent except in 1996. The Bison was available more often than the Grizzly, fluctuating between 75 and 84 percent. In the newer

Coyote fleet, only 43 vehicles were active in 1996. In 1998, when most Coyotes were in service, the fleet's availability rate was 85 percent.

10.33 The semi-annual inspection is an important preventive maintenance activity to detect and fix problems before they get worse. It also determines the general condition of the vehicles in a fleet. The Department is having difficulty keeping up with inspections.

10.34 Using the statistics available for January 1995 to March 2001, we compared rates of inspections outstanding with the goals for inspections outstanding. (Statistics for 1 Canadian Mechanized Brigade Group were not available.)

10.35 We found that the two brigades we looked at are not meeting their respective goals; their availability rates have fluctuated over time. We compared the actual rates with the lowest goal for inspections outstanding, 20 percent or less. In the five fleets we considered at 5 Canadian Mechanized Brigade Group, this goal was met 61 percent of the time. In 2 Canadian Mechanized Brigade Group, it was met 38 percent of the time. More on-time inspections could improve the serviceability of vehicles in the long run.

10.36 **Air Force.** The Air Force calculates operational availability as total time minus downtime for maintenance. The figures are expressed as percentages and are based on a 24-hour day. The Air staff stopped producing reports on operational availability in 1999 because of Year 2000 problems in the information systems used to manage the data.

10.37 From April 1995 to October 1998, all fleets except the Griffon were available for operations only 30 to 60 percent of the time.

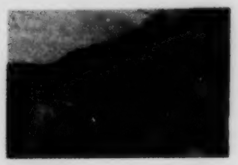
10.38 Data on the Hercules fleet show a downward trend after October 1998. Availability of the Aurora fleet declined from about 55 percent to 42 percent. The Sea King fleet's availability declined from about 42 percent to 29 percent; departmental officials estimated that about half of that decrease was due to downtime for several aircraft modifications and other avionics upgrades, and the rest was for repairs to keep the fleet airworthy.

10.39 Availability of the Griffon fleet increased between April 1995 and October 1998, from about 70 percent to 78 percent. Departmental officials explained that the rate increased as employees gradually acquired competence in operating and maintaining the aircraft.

10.40 Abort rates represent the total number of suspected failures per 1,000 flying hours that result in cancellation of a mission. We found that from 1990–91 to 1999–2000, abort rates increased in all fleets except the Griffon helicopter. Our analysis found that except in the Aurora fleet, all the increases were significant: between 30 and 60 percent (Exhibit 10.5).

10.41 Overall, availability of the aircraft most important to Air Force operations has been low over the last five years and is still declining in the Aurora and Hercules fleets. This is probably due to reduced funding and the aging of equipment. Three fleets are due for major overhaul and rebuilding, and one is due to be replaced.

Army vehicles



Bison

The Bison is a wheeled armoured vehicle acquired under the MILAV (Militia Light Armoured Vehicle) project for reserve force training, primarily as an infantry section carrier, with command post and mortar kits and a vehicle repair variant. It has been adapted for use by the Regular Force with additional ambulance, engineer, and mortar variants built since acquisition. Quantity: 199. Date of purchase: 1990 to 1992.

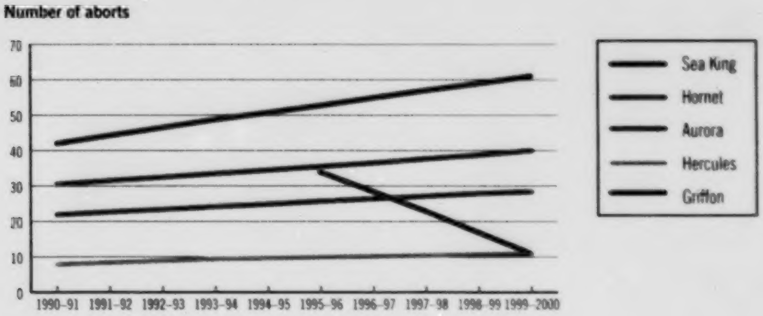
Coyote

The Coyote is a wheeled armoured reconnaissance vehicle used in surveillance missions at the battle group and brigade levels. Quantity: 203. Date of purchase: 1996 to 1998.

Grizzly

The Grizzly is a wheeled armoured vehicle whose primary use is to provide mobility and protection for an 11-person infantry section. Quantity: 265. Date of purchase: 1976.

Exhibit 10.5 Abort rates per 1,000 flying hours, by Air Force fleet



Source: Performa—Air

The Navy and the Air Force need greater equipment support effort

10.42 It is important to know not only whether equipment support functions are reaching their goals but also whether reaching them takes more effort. We therefore looked for trends in the amount of work required to keep equipment available.

10.43 **Navy.** The Navy has maintained its activity rates. Lack of data meant we could not determine the maintenance effort required to achieve these activity rates, but it appears that a maintenance backlog is building.

10.44 In October 2000, the Chief of the Maritime Staff discussed the growing "bow wave" of deferred maintenance. Preliminary studies and analyses have pointed to a backlog. According to their maintenance profiles, Halifax class vessels are supposed to have a total of 12 weeks scheduled each year for corrective and preventive maintenance. But they averaged only 6.1 weeks in 1997, 7.8 weeks in 1998, and 8.7 weeks in 1999. A recent study of the maintenance hours worked by crew on one of the Halifax class ships indicates that ship crew do not have enough time to complete all preventive maintenance routines. A comparison of the maintenance hours that are required with the hours available for maintenance shows that maintenance capacity on Halifax class ships cannot keep up with the required standard. Preliminary data on Maritime Forces Atlantic indicate that the Halifax and Iroquois fleets have significant amounts of maintenance still waiting to be done.

10.45 Several recent decisions have addressed the bow wave of deferred maintenance. For example, Navy headquarters has renewed its Halifax class long-term maintenance review. All deferrals of preventive maintenance are to be tracked, and staff have been encouraged to help with accurate recording of maintenance data. As noted by the Chief of the Maritime Staff, "Chronic deferral of preventive maintenance prejudices not only current availability but also the life expectancy of the ship."

Army vehicles

Heavy logistic vehicle wheeled (HLVW)

The HLVW is a large truck. Ten variants of this vehicle provide support to the land forces. Quantity: 1,208. Date of purchase: 1992.

Medium logistic vehicle wheeled (MLVW)

The MLVW is a truck used throughout the battlefield in such roles as command and control, troop and cargo transport, and maintenance and administrative functions. Quantity: 2,769. Date of purchase: 1982.

Air force aircraft

CH-124 Sea King

The Sea King is a ship-based helicopter carried on board destroyers, frigates, and supply ships. Its primary role is anti-submarine warfare, but it is also used for search and rescue and utility transportation. Quantity: 29. Date of purchase: 1963 to 1969.

CC-130 Hercules

The Hercules is used to airlift troops, equipment, and cargo in search and rescue operations and in air-to-air refuelling of CF-18 Hornet fighter aircraft. Quantity: 32. Date of purchase: 1964 to 1997.

CP-140 Aurora

The Aurora is a long-range patrol aircraft used for land and sea surveillance and for anti-submarine warfare. Quantity: 18. Date of purchase: 1980–81; 1992–93.

10.46 **Army**. The Army appears to have maintained and even increased activity rates between 1989 and 1998 without increasing its maintenance efforts. It has not seen any noticeable decline in the availability of equipment fleets, although readiness has fluctuated in operational units.

10.47 We compared maintenance hours for Army vehicles with vehicle usage by looking at the Department's performance indicator, in-house maintenance hours per 100 kilometres. We found that this measure fluctuated and there were no obvious trends in any of the five fleets.

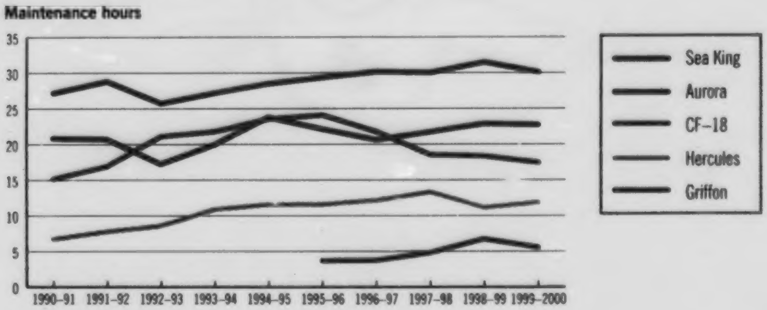
10.48 Although most vehicles have been in service for a long time, generally the ratio of maintenance hours to kilometres is not increasing. However, total maintenance hours are increasing significantly in all fleets except the MLVW, where they have decreased, and the Grizzly, where they have fluctuated.

10.49 **Air Force.** The Air Force has significantly reduced its activity, and its ability to keep equipment available has declined.

10.50 For the Hercules and the Sea King, the two oldest fleets, we found significant increases in the ratio of total maintenance hours to flying hours from 1990–91 to 1999–2000, namely, 62 percent for the Hercules and 16 percent for the Sea King. In the Hercules fleet, corrective maintenance accounted for most of the increase. Even though the Hercules flew about 37 percent less in 1999–2000 than in 1990–91, total hours of corrective maintenance increased about 26 percent; the ratio of corrective maintenance hours to flying hours doubled (Exhibit 10.6).

10.51 Departmental officials attribute the increase in maintenance of the Hercules and the Sea King mainly to the aging of the fleets. Other factors were the loss of expertise in aircraft maintenance due to the military force reduction program in the mid-1990s, and the amalgamation of aviation technician trades, also in the mid-1990s.

Exhibit 10.6 Annual maintenance hours per flying hour, by Air Force fleet



Source: Performa—Air

Maintenance personnel

Providing maintenance personnel has become problematic

10.52 National Defence employs about 15,000 military personnel in 36 military maintenance occupations to service major equipment of the Canadian Forces. We did a comprehensive analysis of military maintenance personnel in 49 operational units and large maintenance depots. We included the 202 Workshop Depot in the Army analysis; although it is part of the Materiel Group, it is the major land vehicle depot. Our analysis identified significant shortages of personnel and a lack of qualified staff.

10.53 The Department estimates that the armed forces are having critical difficulties staffing 18 of the 36 military maintenance occupations. In some cases, these occupations are at 10 percent or more below staffing targets; in other cases, the Department estimates that recruitment and training will not be sufficient to reach staffing targets before 2003. Departmental projections also indicate that for the next year or two, eight additional maintenance occupations will be staffed at 5 to 10 percent below target levels.

Air Force aircraft

CH-146 Griffon

The Griffon is a transport for the airlift of equipment and personnel, command and liaison flights, casualty evacuation, and logistic transport. It has limited use in search and rescue. Quantity: 99. Date of purchase: 1995 to 1997.

CF-18 Hornet

The CF-18 Hornet is a fighter jet whose primary roles include air interception, air control, and tactical bombardment. Quantity: 122. Date of purchase: 1982 to 1988.

10.54 We asked the maintenance units in our sample of 49 to identify any significant personnel shortages at 1 March 2001 and assess the impact on their exercises and operations. Overall, 13 percent of positions in the units are vacant—16 percent in the Navy, 14 percent in the Army, and 11 percent in the Air Force. Navy units reported significant shortages on the West coast in trades such as naval electronics technicians, marine engineer technicians, and maritime engineers. Army units have significant shortages of vehicle technicians, weapons technicians, materiel technicians, and fire control technicians. Air Force units cited significant shortages of aviation systems technicians, avionics systems technicians, and aircraft structure technicians. Units of the three services acknowledged that shortages have had an impact on training and operations, but they were not specific about its nature and extent. The Navy reported that it had deferred a large amount of preventive and corrective maintenance and some crew had not met some minimum requirements—sea watch keeping and weapons certification, for example. Army and Air Force units mentioned that in many cases there are enough people to fill positions, but some of them are inexperienced, untrained, or not deployable.

10.55 Many military personnel in maintenance occupations do not hold the qualifications their ranks require. We compared the qualifications required for specific ranks with the qualifications of maintenance personnel at those ranks. We found that 15 percent did not have the required qualifications.

10.56 The units in our sample require specialty training for specific positions. However, we note that military personnel in units are managed in groups; a person can be assigned to a position and not necessarily work in it. We took this practice into account. Overall, we found that military personnel had not taken 38 percent of the specialty courses required for the positions they were working in. Broken down by service, the figures were 27 percent in the Navy, 36 percent in the Air Force, and 61 percent in the Army (42 percent accounted for by a single course, military wheeled vehicle driver).

10.57 Although they were not specific about the impact of lacking qualified personnel, units did tell us that personnel must not only be qualified but also complete specialty courses and acquire experience on the job. In some occupations, maintenance personnel may need up to two years on the job before they can work unsupervised, and another five years to qualify in a specific expertise. This apprenticeship period must be completed before they receive additional specialty courses. Units also said that along with required specialty courses, many safety-related courses—such as first aid, firefighting, and weapons training—should be prerequisites for supervisors.

There are shortfalls in staffing

10.58 To meet National Defence staffing priorities, each of the three services must staff units deployed on missions at 100 percent and operational units at 92 percent. In the sample of units we audited, the three services do not always meet the staffing targets for maintenance occupations. We found that none of the major Navy warships on the West Coast meet staffing targets. Staffing of maintenance positions on destroyers, frigates, and supply ships varies from 50 percent to 80 percent. Army service battalions in Edmonton and Petawawa are staffed at 87 percent and 79 percent respectively. Only 4 of the 10 Air Force units meet the staffing targets for maintenance positions.

10.59 Units must also meet standards of readiness. Each unit must have personnel and materiel at the levels needed to respond to White Paper tasks. The readiness of a unit is determined by its manning, equipment, and training, and must be attainable within a specific length of time. Response time is the time it takes a unit to be fully staffed and equipped to respond; this includes training time and logistics support.

10.60 Required levels of personnel readiness vary among the services. According to manning guidance provided by the Vice Chief of the Defence Staff, most Army and Air Force operational units are to be staffed at a minimum of 92 percent. In our sample of units, we found that only one of the three Army service battalions meets the goal and around 50 percent of the Air Force units fall short. The Navy is implementing its April 2000 readiness and sustainment policy, though it has not been officially approved. The new policy stipulates that ships at high readiness must be staffed no lower than 95 percent, and ships at standard readiness at about 75 percent. Ships at extended readiness are staffed only with custodial crew. We found that 5 of 13 ships at high readiness did not meet the target. But staffing on 16 of 17 ships assigned to standard or extended readiness greatly exceeded the targets.

Provision of spare parts

Spare parts are provided slowly

10.61 Keeping equipment in service requires an adequate supply of spare parts. The vast majority of spare parts are provided through the Canadian Forces Supply System. The system monitors about one million line items, including new parts purchased and used parts repaired and overhauled. The total value of the spare parts was about $10 billion in 2001. The supply system has been used since 1974 and has been undergoing a major upgrade since the early 1980s. Completion of the upgrade was scheduled for summer 2002.

10.62 We examined the extent to which the supply system provides the spare parts the Canadian Forces need when they need them—from within 30 days to within two days. Parts ordered for delivery within two days are considered an urgent requirement with an immediate impact on operations.

10.63 We examined spare parts data from 1995 to 2000 for the Navy, Army, and Air Force fleets in our audit sample (this did not include the Griffon and the Maritime Coastal Defence Vessel, which are serviced by contractors and not by the supply system). We analyzed only the demands for spare parts needed for repair or replacement; we did not look at routine restocking of inventory.

10.64 Exhibit 10.7 shows the success rate of each service in providing spare parts within deadlines to the fleets we examined. While the performance of the current supply system is low for parts needed urgently, it is consistently high for 30-day requirements. Between 1995 and 2000, the rates remained stable, despite a drop in total demand in two of the three services. Low success rates reflect the difficulty of procuring or repairing spare parts and delivering them to the needed locations under tight deadlines.

10.65 We found that over this period the Army's total demand for spare parts was constant. Demand in the Air Force declined 25 percent and in the Navy 45 percent.

10.66 Our audit did not find significant problems in the overall level of service the Canadian Forces Supply System provides. However, we did find cases where maintenance problems, including inability to obtain spare parts, created major challenges for the operations of entire fleets of equipment over long periods of time (see case studies on pages 14 and 15).

Exhibit 10.7 Success rates in providing spare parts within deadlines, 1995–2000

[illegible]	[illegible]	[illegible]	[illegible]
2 days	34%	37%	45%
7 days	54%	44%	63%
14 days	55%	60%	72%
30 days	92%	92%	98%

Note: Success rates are weighted averages.

Source: Canadian Forces Supply System database

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Examples of major repair problems

Aurora flight director indicator

Delays in management decisions severely degraded the effectiveness of the Aurora long-range patrol aircraft for over five years.

The Aurora is a long-range patrol aircraft used for maritime, arctic, and environmental surveillance; pilot training; and search and rescue. There are 21 aircraft in the fleet. The flight director indicator (FDI) on each aircraft is designed to provide a warning to the pilot when the instrument's power or aircraft attitude (wing tilt) data are interrupted. Unfortunately, the FDI does not provide a warning if the instrument suffers an internal failure. Internal failure causes the instrument display to "freeze" in its last position and it stops giving the pilot reliable information on aircraft attitude. Freezing of the FDI without a warning so the pilot can switch to backup instruments is a hazardous condition that could contribute directly to an aircraft accident.

The flight director indicator was the subject of several flight safety incidents between February 1997 and August 2000. The warning is not reliable. In 1998, an airworthiness risk assessment rated this as an *extremely high* risk, making it necessary to restrict the operations of the fleet. This precluded flying at low levels, at night, and during periods of reduced visibility, all essential to the aircraft's mission and to training. The Aurora Incremental Modernization Program (AIMP), a major avionics upgrade program, was not considered a solution to the problem because it involved a five-year delay.

In February 2001, four years after identifying the problem, the Department issued a contract to the original supplier to overhaul components and spares of all flight director indicators. The overhaul was to start by June 2001 and be completed by December 2001. All spares will be overhauled by May 2002. Based on the current inventory, 80 instruments will be overhauled at a cost of $10,000 each, for a total of $0.8 million. The flight director indicator will later be replaced under the incremental modernization project.

The Department estimated the replacement cost of the FDI at $50,000 each, or $4 million for the entire inventory.

It will have taken the Department 63 months, from the first flight safety incidents in 1997 to the scheduled completion of the overhaul in 2002, to address a relatively minor problem that severely degraded a major weapon system.

Hercules avionics update project

Inadequate planning by the Department affected the operational readiness of Hercules aircraft.

The Hercules transport fleet of 32 aircraft is used to support operational missions, including strategic and tactical airlifts and search and rescue. An avionics program to upgrade the fleet was initiated in 1994. The upgrade was carried out from 1998 to 2001. By September 1999, only 18 months after the upgrade began, all spare parts had been depleted—though only 12 of 32 aircraft had been upgraded. Three months later, the Department undertook a study to find out why.

Two factors led to the delay in acquiring needed spares: the upgrade was tailored to Canadian Forces requirements, and it involved a small number of aircraft. The Department did not foresee that these two factors would cause lengthy delays in acquiring needed spares.

It took the Department 18 months to identify the problem, and 30 months will have elapsed before all the new spares are delivered. Additional spare parts have cost just under $13 million so far. Our main concern is not the additional cost or the early depletion of spare parts but the delay, during which aircraft were not available or were less useful.

Examples of major repair problems

Maintenance problems in Hercules aircraft

The Hercules fleet has not met operational requirements for serviceable aircraft.

The Department has 32 Hercules aircraft, 20 of them at 8 Wing–Trenton. We found that the Department has not always had enough serviceable Hercules at Trenton to achieve the tasks assigned to the fleet. On average, 13 percent of the time there have not been enough serviceable aircraft. The situation was at its worst in 2000–01, when 35 percent of the time not enough aircraft were serviceable.

Destroyer and frigate spare parts

Lack of timeliness in acting on a 1996 study to rationalize on-board spare parts caused the Iroquois class destroyers to carry $29 million in surplus spares for 57 months.

The Navy started the Warship Allowance Rationalization Project I (WARP I) in February 1996 to get rid of excess stock that Iroquois class destroyers were carrying. The plan was endorsed in January 1998, and the project proposal produced in June 1998. In February 2000, inventory managers estimated the value of excess stock for potential reduction at $29 million. Technical review and validation confirmed the estimates in June 2000, two years after the project proposal was produced. This two-year interim was needed for inventory managers and materiel managers to negotiate the numbers of spares needed on board and the acceptable risk of running out of stock. According to the plan, the unloading was to be completed by November 2000.

WARP II is a corresponding initiative for the Halifax class frigate. A November 2000 statement of work launched a study of the feasibility of offloading spare parts, to be completed by August 2003—even longer than the corresponding study for the destroyers. Based on WARP I, a further period of technical validation and negotiation can be expected to extend this initiative another two years. In March 2001, the value of excess stock for potential reduction was estimated at $26 million.

Iroquois class ships are carrying enough spare parts for certain items for about 20 years. Financial pressures on all naval budgets call for rationalizing the spares on board, for both efficiency and economy. Money spent on spares that will never be used ties up funds the fleet could use elsewhere. The decision on whether these items should be disposed of will be the subject of a WARP III project.

Impacts on operational training and deployments

Budget shortages and equipment support difficulties have affected training and deployments

10.67 Equipment must be maintained and available to ensure that collective training, exercises, and operations are conducted as planned and to prevent any negative impact on a unit's readiness. We set out to assess the impact that problems in equipment support may have had on Canadian Forces exercises and operational readiness.

10.68 Collective training and exercises assess the ability of the Canadian Forces to perform high-level tasks. They contribute to the readiness of the troops by maintaining their essential expertise and skills—in both combat arms and equipment support.

10.69 The Department provided us with post-exercise reports on 41 percent of exercises completed by the Navy, Army, and Air Force between 1998–99 and 1999–2000 that used major equipment. We reviewed those reports, departmental business plans, and post-deployment reports.

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10.70 From the documents we reviewed, we could not conclude whether cancellation of exercises was related to equipment support difficulties, financial constraints, or increased operational demands. However, our review of departmental documents identified a number of equipment support problems that affected collective training and exercises.

10.71 **Navy.** Two of five post-deployment reports produced by Maritime Forces Atlantic cited spare parts problems. Both of these were related to the Sea King helicopters on board ships for exercises. In general, poor availability or capability of aircraft for missions results in the loss of many good training opportunities and severely restricts the service that the Helicopter Air Detachment can provide to the ship.

10.72 Five of nine Maritime Forces Pacific exercises for which we found post-exercise reports noted spare parts problems. The two problems cited most often were insufficient spares in the pre-deployment pack-up kits and the length of time it takes to ship and receive parts from Canada. These problems have affected exercises. For example, during an exercise a frigate experienced critical system failures and had no pack-up kit available. As well, when one of its diesel engines failed, an urgently needed part had to be flown to the nearest port. Repairs took longer than anticipated, due to the challenges of depending on a commercial flight. The deployment was eventually redefined because of this marine system operational deficiency.

10.73 To maintain operational commitments, the Navy has moved to a "tiered readiness" system, allowing the use of resources to remain as flexible as possible. This means that some ships are kept at a lower level of readiness than others.

10.74 **Army.** In order to use its available resources to maintain operational commitments, the Army has significantly reduced its training of combat teams and battle groups. Combat team training is the minimum level that must be maintained to ensure continued competence in general-purpose combat operations. Below this level, there is a risk that the unit could not respond within the warning times stated in the Defence Planning Guidance. Today, only units being sent on operational missions receive training above the combat team level. This has led to less-than-optimal levels of training and a decline in combat arms and warfighting skills throughout the Army.

10.75 Vehicle shortages have led to the moving of a fleet of vehicles from one brigade area to another to carry out training. The Army's lessons-learned report on Operation Palladium noted that all unit and brigade areas had trouble getting Bison armored personnel carriers to use in training; there simply are not enough to meet the demand. As a result, drivers of the Bison, and in some cases the other wheeled armoured vehicles, were sent to Bosnia–Herzegovina with a minimum of experience. This problem had occurred previously in Operation Alliance and Operation Stable.

10.76 The 2 Canadian Mechanized Brigade Group (Petawawa) received 34 Grizzlies, two AVGP Huskies, and two Bison from Land Force Western Area (Edmonton) to support its training for Operation Palladium. This equipment had been driven hard in preparing several rotations of troops for missions. The lack of ownership by the units using the equipment resulted in poor maintenance and thus low serviceability. Inspections showed that the fleet arrived with 92 percent of vehicles not in service while they underwent repairs. This fleet was also a significant burden to the Brigade once training was completed, because it then had to be sent to Land Force Quebec Area to prepare for deployment. Army officials told us that they now own enough LAV III vehicles to meet training requirements.

10.77 **Air Force.** During 1998–99, officers of 8 Wing reported that in two of six collective training exercises they had to change unserviceable Hercules aircraft several times to complete the exercises. In 1999–2000, exercises were reduced dramatically. It is getting harder for both aircrew and support personnel to keep their training up-to-date.

10.78 Over the past three years, the lack of available spare parts has greatly impeded 8 Wing's global and domestic training. Its 2000–01 business plan states that if the shortage of spare parts for an aging fleet is allowed to continue, readiness will inevitably decline. This could also have safety implications.

10.79 We found that 10 of 27 post-exercise reports by 14 Wing on Aurora exercises in 1999–2000 show that deficiencies in the flight director indicator interfered with the success of the exercises. As well, 5 of 16 post-exercise reports by 19 Wing on Aurora exercises in 1999–2000 note that the exercises were affected by problems in the delivery of spare parts. Two of those five reports said that missions were cancelled and training opportunities lost as a result.

10.80 We reviewed 61 post-deployment reports on the use of the Sea King aboard ships from 1 April 1995 to 31 March 2000. We found that 54 of the reports mention at least one of the following problems: scheduled mission that was cancelled for aircraft maintenance; mission degraded by aircraft's lack of serviceability; poor serviceability that had a negative impact on training; major snags that caused significant downtime; and aircraft that were grounded. Examples of the Sea King serviceability problems are illustrated in the extracts of the reports shown in Exhibit 10.8.

Collective training and exercises are being scaled down

10.81 Two of the services gave us examples of exercises that had been scaled down. These exercises were conducted with fewer personnel or less equipment than originally planned, due to technical reasons, unavailability of equipment, movement of personnel, or financial constraints. We were unable to determine how many exercises had been reduced and with what overall impact.

10.82 The Navy on both the East and West coasts provided four examples of ships that have reduced or cancelled their participation in an exercise since 1998. For example, HMCS *Montreal* reduced its participation in a major exercise from five days to one day because of ongoing technical problems;

HMCS *Iroquois* cancelled its participation for technical and personnel reasons. Financial constraints were a factor, but not the deciding one.

10.83 Two of the three operational Army brigades gave us examples of exercises that had been scaled down. In one case, Leopard and Coyote squadrons were not deployed as scheduled, due to financial constraints and unavailability of vehicles. Furthermore, the number of personnel involved was reduced from 2,415 to 1,516 before the exercise began.

Exhibit 10.8 Sea King serviceability problems

High unserviceability

"I can honestly say that in the 17 years I have spent in the Sea King community, through all my deployments, this is the first time I was sincerely embarrassed to be associated with this helicopter, due to her constant and consistent unserviceability and resultant air detachment inability to contribute meaningfully to the ship combat capability or the force in general." (NATO deployment, 10 August to 15 December 1998)

Poor serviceability had a negative impact on training

"As can be seen by Salty Dip 1/95, more than one Sea King may be required to successfully complete the exercise. In this case, five aircraft were used in only three and a half flying days. This meant that subsequent aircraft were not completely equipped and valuable training was missed." (Salty Dip exercise, 11 to 20 April 1995)

Availability of aircraft lowered motivation and morale

"The limited operational capability and availability of the CH-124A had a profound impact on the motivation and morale of the members of the detachment. Many found it difficult to rationalize the motivation required to work extremely long hours to make airworthy an aircraft that was rarely fully mission-capable and, even when mission-capable, of extremely limited tactical benefit to the ship." (Work-ups, HMCS *Iroquois*, 31 May to 26 June 1999)

Some deployments have been affected

10.84 To determine the impact of equipment support problems on operations, we reviewed end-of-tour reports. The Canadian task force commander is required to submit an end-of-tour report at the end of each mission rotation. The report describes the major problems of the mission as a whole and their impact on the Canadian contribution. Of the 29 required reports, the Department provided us with 21. Two were never completed and six remain unaccounted for.

10.85 The end-of-tour reports provided by the Department cover seven of the eleven missions in our sample (Exhibit 10.9). Of these seven missions, five reported problems getting spare parts—mainly the amount of time it took to get parts to the theatre. We were unable to determine the impact of these problems on operations. In one case, however, aircraft were grounded while awaiting parts; in another case, Canadian CF-18 Hornet crews borrowed parts from the Spanish Air Force so they could conduct operations.

End-of-tour reports were not explicit enough for us to establish the extent of the problem.

10.86 The recent CF–18 Hornet deployment to Aviano, Italy on Operation Echo, part of the North Atlantic Treaty Organization (NATO) contingent in Kosovo, illustrates some of the spare parts problems (Exhibit 10.10).

10.87 Canadian Air Force CF–18 Hornet aircraft had been sent earlier to Aviano, Italy as part of Operation Mirador flying missions in Bosnia–Herzegovina. The end-of-tour report noted that spare parts and equipment critically needed to keep the CF–18 Hornet serviceable were improperly routed, incurring unnecessary costs and leaving aircraft on the ground and unserviceable. Fortunately, the pace of operations and the exceptional work of the aircraft technicians meant that all operational tasks were completed.

10.88 The end-of-tour report on Operation Kinetic, Rotation One, to Kosovo noted that when spare parts and equipment needed immediately were more than the Hercules sustainment flight could carry, the units waiting for them had no opportunity to assign priority to items, or even to learn which items would be on the flight.

10.89 We were provided with six out of seven end-of-tour reports on Operation Palladium in Bosnia–Herzegovina. The reports highlight a number of impacts that equipment deficiencies had on operations. Exhibit 10.11 provides an overview of the problems encountered on each rotation.

Exhibit 10.9 Eleven international missions in our audit sample

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1	Tranquility	Persian Gulf	1	0	210	4	29
2	Alliance	Balkans	3	2	1,029	53	203
3	Stable	Haiti	3	2	2,250	50	158
4	Assurance	Zaire/Rwanda	1	0	354	15	41
5	Prevention	Persian Gulf	1	0	210	3	42
6	Mirador	Italy/Bosnia–Herzegovina	1	1	112	2	33
7	Determination	Persian Gulf	1	1	338	4	51
8	Palladium	Bosnia–Herzegovina	7	6	1,649	492	1,518
9	Echo	Italy/Kosovo	8	8	102	57	760
10	Kinetic	Kosovo	2	1	1,300	235	516
11	Toucan	East Timor	1	0	721	34	127
	Total		29	21	8,275	949	3,478

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4	Assurance	Zaire/Rwanda	1	0	354	15	41
5	Prevention	Persian Gulf	1	0	210	3	42
6	Mirador	Italy/Bosnia–Herzegovina	1	1	112	2	33
7	Determination	Persian Gulf	1	1	338	4	51
8	Palladium	Bosnia–Herzegovina	7	6	1,649	492	1,518
9	Echo	Italy/Kosovo	8	8	102	57	760
10	Kinetic	Kosovo	2	1	1,300	235	516
11	Toucan	East Timor	1	0	721	34	127
	Total		**29**	**21**	**8,275**	**949**	**3,478**

Exhibit 10.10 Spare parts problem—CF–18 Hornet deployment on Operation Echo

"The re-supply of batteries. Spare CF–18 Hornet batteries were not brought from 3 Wing for the initial deployment (Rotation Zero). Hence, there were no spare batteries at the beginning of the operation. This oversight was corrected by ordering spares at the beginning of the operation, but delivery was unacceptably long. Rotation One arrived in-theatre with no spare aircraft batteries. They were automatically ordered immediate operational requirement and received two months later. The batteries were received depleted and chargers had to be ordered. The CF–18 Hornet batteries have to be charged at every supplementary check (every 100-flight hours). After having done some of these inspections in Aviano, the stock of spares was depleted. Once again, the batteries were ordered immediate operational requirement but it took an unacceptable time to get them. This forced an extension to the life of the in-aircraft batteries beyond the authorized limits in order to meet operational requirements. Finally, as an interim measure and to maintain operational effectiveness and preserve flight safety, batteries were borrowed from the Spanish Air Force."

Source: Operation Echo, Aviano, Italy, end-of-tour report

Exhibit 10.11 Problems encountered by Operation Palladium

Rotation Zero. "Too often, vehicles sat in maintenance awaiting parts, sometimes for several weeks. These delays often impacted on the operation's effectiveness. Spare parts delivery for the Grizzly was slow and had a direct impact on the unit's effectiveness."

Rotation One. "Maintenance support to CCSFOR (Canadian Contingent Stabilization Force) has been good. The only difficulties encountered have been the result of delays in obtaining spare parts. The problem is not critical but does require constant monitoring."

Rotation Two. "The maintenance of the AVGP (armoured vehicle, general purpose) fleet is also an ongoing challenge as vehicles are in constant need of maintenance due to high-usage rates, the terrain, and the age of the fleet."

Rotation Three. "Several specialist trades are returning too frequently. The size of the Land Force combined with a long-term commitment to stay in Bosnia–Herzegovina means many soldiers could be faced with successive tours. On several occasions immediate operational requirements (IORs) parts for the Griffon helicopter sat at Trenton and was not placed on the first available flight. The average time for an IOR to reach Bosnia was 5–6 days. The quickest was three days and the worst was twelve days."

Rotation Four. "Tour fatigue issue was raised as several specialist trades are returning to this theatre too frequently. As well, certain positions have been under-ranked in order to fill them. This problem is exacerbated by a Forces-wide reduction in the number of courses necessary to qualify soldiers to the next rank level."

Rotations Five. "Problems were encountered in the delivery of spare parts (aircraft on ground) to the Griffon helicopter detachment. As well the tour fatigue and under-ranking of positions is once again reported."

Rotation Six. End-of-tour report was not completed.

Source: Operation Palladium, Bosnia-Herzegovina, end-of-tour reports, 1997–2001

Equipment readiness information

Management lacks much of the necessary information

10.90 Management information needs to be available and used to manage personnel, spare parts supplies and inventories, equipment status, and operational readiness. We found in general that the needed data were often unavailable, except data on spare parts. The information that was available was inadequate, incomplete, and often inaccurate.

10.91 Information on the state of equipment is collected separately by the Canadian Forces, by each service, and by individual support functions such as human resources and supply. We examined the Department's capacity to provide adequate information at each of those levels on the state of its equipment and equipment support functions.

10.92 **Canadian Forces.** In March 2000, the Canadian Forces introduced the Operational Status Display system. This system reports on the status of the Canadian Forces Vanguard units (the quickly deployable standby forces called for in the 1994 Defence White Paper). It also tracks the history of their readiness based on information provided and updated weekly by readiness systems of the Navy, Army, and Air Force. The Operational Status Display system reports on 4,000 personnel, around 7 percent of the Canadian Forces.

10.93 There is no system, however, that provides an overview of the state of all major weapons platforms operated by the Canadian Forces.

Reports on collective training and exercises often not completed and analyzed

10.94 Each service's Chief of Staff requires that a post-exercise report be completed at the conclusion of an exercise. Post-exercise reports provide information on what the exercise was supposed to accomplish, what actually was accomplished, and what problems or successes occurred. They permit the Canadian Forces to learn and benefit from the exercises they conduct.

10.95 We were provided with 41 percent of the post-exercise reports required across the Canadian Forces for 1998–99 and 1999–2000 (Exhibit 10.12). Departmental officials were unable to confirm whether the missing reports had not been produced or could not be found. Those that were provided to us were not specific about the effects of equipment deficiencies on exercises. For example, the Navy post-exercise report policy states, "Comments of special significance or vital interest or items which may require extensive detailed explanation should be briefly covered in the report and then be followed by a separate correspondence."

10.96 **Navy.** The Navy's Operational Deficiency report is used to tell formation and operational commanders about restrictions on the capability of their fleet units to conduct operations. Units submit these reports when equipment fails to meet established performance criteria.

10.97 The Navy has begun collecting systematic data on availability and serviceability of major systems. In 2000, the Consolidated Maintenance Information System (CMIS), which collects information such as maintenance hours, started to collect data on reliability, availability, and maintainability (RAM). RAM data are collected for certain major subsystems on the Halifax

and Iroquois class ships. However, the Navy will have to overcome problems in the system in order to obtain useful information from it.

10.98 Data on corrective and preventive maintenance hours, obtained at our request from CMIS for 1996 to 2000, contained significant errors. According to Navy officials, the errors were mostly due to difficulties with data query techniques. For example, preventive maintenance hours on Halifax class ships in 1998 were shown initially at 1,050,394 and later were revised to 182,772. Officials explained that the revised number is the more accurate, thanks to recent improvements in the data query techniques and significant efforts to clean up data.

10.99 Several factors have influenced the accuracy and currency of the data. Navy officials explained that to simplify the development of the information system, data on minor maintenance were initially excluded. The Navy only recently started again to record hours for certain minor preventive maintenance routines—routines that nonetheless cumulatively represent a significant amount of maintenance. Some maintenance action forms were entered into the system more than two years after they were created, and the figures were only estimates. Some data were lost due to bad disks and server crashes. Often data entry is not timely.

10.100 We noted deficiencies in the recording of maintenance costs. The Navy does not keep separate track of the costs of spare parts consumed.

10.101 **Army.** The equipment status reports used by Army brigades provide a monthly overview of the state of each brigade's vehicles; units carrying out missions provide weekly reports. But the reports do not deal with the impact of equipment deficiencies on operations and exercises. At the conclusion of our audit, the Army was in the process of validating its reporting system.

10.102 We noted that brigades do not always prepare monthly reports. Moreover, brigade reports are not prepared on a consistent basis and there are some key differences among them. In their equipment status reports, for example, brigades apply different definitions of "operational" to vehicles. And they use different criteria to decide whether a vehicle undergoing maintenance is serviceable.

Exhibit 10.12 Post-exercise reports (1998–2000) received

Service	Number required	Number received	Percentage received
Navy[*]	114	41	36
Army	83	29	35
Air Force	314	140	45
Total	**511**	**210**	**41**

[*] The post-exercise reports provided by Maritime Forces Atlantic were in draft form, as none had been approved through the chain of command since 1997.

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*The post-exercise reports provided by Maritime Forces Atlantic were in draft form, as none had been approved through the chain of command since 1997.

10.103 While the brigade reports may meet the needs of individual brigade commanders, unless they all report the same kinds of information in a consistent, comparable way their usefulness for reporting operational readiness to National Defence headquarters is limited.

10.104 Since 1979, the Army has collected additional data centrally on the operational availability of equipment. When a new software control system was put in place in 1999, the collection of data at National Defence Headquarters was interrupted; central data collection was reinstituted in fall 2000 and a new central data collection system was not completed until April 2001.

10.105 In deployed units, maintenance staff prepare two reports on the operational status of equipment. The first report provides statistics only on the serviceability of various automotive systems. The second report provides data on serviceability of the weapons and fire control systems attached to the vehicles. The two types of statistics are not rolled up to provide an overall picture of the state of the deployed equipment.

10.106 **Air Force.** The Department could not provide complete, accurate information on aircraft availability beyond April 1999, because its data system did not survive the Year 2000 changeover. The last data the system generated did not include all downtime for maintenance and therefore overestimated the availability of aircraft for operations.

10.107 The Department does not have an official standard for the operational availability of aircraft. The main goal of the maintenance section is to meet the operational requirements of the flying crew. One way the maintenance section evaluates performance is by comparing the number of successful flights with the number of flights planned by operators. However, we found cases where units did not plan missions if they knew aircraft were unserviceable, and their statistics thus overstated operational availability. We also found that for some missions, there were no historical records comparing completed sorties with planned sorties.

10.108 **Personnel.** In 1997, the Department began implementing PeopleSoft, a new personnel management information system. In August 2001, the Department was upgrading the system; however, it needs to improve user training. Users do not help improve this central system. For example, they do not enter qualification data into the system consistently or in a timely way. Instead, users have developed parallel and duplicate systems to gather personnel data but have failed to enter those data regularly in the corporate system.

10.109 We asked the Department what percentage of military personnel had successfully completed specialty courses and at what qualification level. While the PeopleSoft system is able to track this information, the data either had not been entered or were not accurate. We had to compile the data manually by contacting individual units.

10.110 **Information systems.** Data are too inaccurate or incomplete to indicate how ready major equipment is and to determine cost trends. Also, the Department is not realizing the full benefits of some systems, such as CMIS and PlannExpert. It needs to improve its information systems and audit the quality of the data they produce.

10.111 The lack of adequate information is a serious problem, with potential consequences for both costs and operations. Poor information on the state of equipment makes it hard to control costs. Senior management cannot determine accurately how much it could save by reducing levels of readiness, as it plans to do. Poor scheduling of repairs and overhaul and the late detection of fleet-wide component failures create inefficiency. Poor information increases the likelihood that tools, equipment, and spare parts will be overstocked or understocked.

10.112 Without good information on the state of major weapon systems, it is hard to determine how ready the Canadian Forces are for major operations. It is difficult to verify the Department's repeated assurance that the Canadian Forces are more combat-capable than they were 10 years ago. That assurance is questionable, given the declining readiness of the major aircraft fleets, the impairment of the CP–140 Aurora's capability for maritime patrol, and the growing backlog of naval maintenance work.

10.113 The failure to make required post-exercise and end-of-tour reports and the poor quality of many of the databases we examined indicate a lack of management discipline.

Corrective action

The Department is taking steps to correct the problems we found

10.114 At present, needed information is scattered among 1,300 systems in all services and locations, each developed to meet particular objectives. Many different users now collect the same data for various purposes. The accuracy of the data is often questionable. These systems do not readily transfer information to other systems; when transfer occurs at all, it is typically by disk or on paper.

10.115 In 1994, the Department recognized that it needed an integrated system for materiel acquisition and support functions, harnessing work that had started on the development of separate information systems for the Navy, the Army, and the Air Force. The Materiel Acquisition and Support Information System (MASIS) project received preliminary approval in 1998. MASIS was launched in September 1999 at the 202 Workshop Depot in Montreal. It is now being implemented across the Department and is expected to be operating fully by 2004. The goal of the system is to provide integrated information for materiel acquisition and support functions such as engineering, logistics, equipment configuration, project management, maintenance, operational support, analysis for decision making, and contract management.

10.116 The Department believes that MASIS will not only reduce the cost of maintaining actual information systems but should also contribute to improved availability of equipment, better inventory of spare parts, and lower maintenance costs in both dollars and personnel. The Department's sharing of this information with manufacturers and contractors is intended to make all three more efficient.

10.117 According to departmental officials, the Canadian Forces Supply System Upgrade (CFSSU) project will deliver a much improved tool to manage inventory, including better visibility to the users and better delivery of materiel to customers. The capabilities of this system will be complemented by a distributed resource planning module that will optimize procurement, warehousing, and distribution. The implementation of the CFSSU will be completed by the end of summer 2002, and then the Department will begin to implement the distributed resource planning module.

10.118 The Department is developing a framework for reporting to the Chief of the Defence Staff on its management of overall performance across the Canadian Forces, including their operational readiness. Each service will provide data on its readiness, which will be integrated with other information on results to give senior staff a much more complete and balanced look at the status of the Canadian Forces. The Department has been developing a readiness reporting system since 1994 and intends to have the performance measurement framework in place by mid-2001.

10.119 Through the Materiel Acquisition and Support Desktop tool, the Department is also actively pursuing its in-service management policy and updating its business processes. The aim is to have performance standards and goals for the equipment and associated data collection requirements addressed adequately in the acquisition phase, and observed during the in-service phase. The Desktop serves as one of the Department's primary tools for knowledge management.

10.120 Finally, equipment acquisition and upgrade programs should greatly increase aircraft serviceability. In particular, the upgrades of the CP–140 Aurora and CF–18 and the replacement of the Sea King should have a significant impact. The upgrades will not be completed for a number of years, however, and no delivery date has been set for the Sea King replacement. In the meantime, the Air Force will probably be unable to increase the readiness of its equipment.

Conclusion and Recommendations

Information management systems not up to the job

10.121 The Department's most significant problem is that its information management systems are not up to the job of supporting the management of Canadian Forces equipment. The lack of information makes it difficult to determine whether or not maintenance practices are efficient. It also presents a serious barrier to the Department's plan to economize by reducing readiness systematically to minimum levels. Moreover, without adequate standards for equipment maintenance and the ability to measure whether they have been met, it is difficult to know whether low-readiness forces could be regenerated, if necessary, in the time prescribed in the White Paper.

Lack of qualified people to support equipment

10.122 The Department is also having difficulty staffing its equipment support organization. There are too few support personnel to staff operational units and major maintenance depots at required levels. Equally serious is that many equipment support personnel—about 15 percent—lack the qualifications required at their ranks. In addition, maintenance personnel lack a large amount of the specialty training required in their particular units.

10.123 Nevertheless, over the last five years the Canadian Forces have been able to maintain the level of activity of the Navy and increase that of the Army. Air Force activity levels have declined, due mostly to budget cuts and the reduced need to keep a large portion of the Canadian Forces at a high level of readiness.

10.124 The military maintenance services of the Department have been able to keep equipment serviceable at fairly constant levels, though in the Air Force the level is declining as aircraft age.

10.125 Over the last five years the Department has maintained its ability to provide spare parts for equipment, but at a low level of service. Most parts that are needed urgently are not received on time. Except in a few specific cases, our audit did not establish a correlation between the availability of spare parts and the availability of equipment to support operations.

10.126 There is some evidence that the inability to keep equipment repaired has hampered training and operations, but it has not resulted in any critical shortages of equipment. Overall, the level of service appears to be adequate to the present level of tasking—but only adequate. It appears that the Canadian Forces do not have much capacity to tolerate further decline.

10.127 **Recommendation.** National Defence should take steps to ensure that it can manage effectively the readiness of its most important equipment. In particular, it should set standards for readiness that would provide for clear maintenance objectives in individual units and against which senior management at headquarters could assess the readiness of entire fleets.

Department's response. This Department applies a variety of safety and operational standards for determining whether individual pieces of equipment are able to perform assigned missions. Due to the very situation-dependent nature of concepts such as "readiness" and "availability," however, assigning common standards and determining collective readiness represents a complex and costly proposition. Although National Defence does not yet have a reporting system that tracks overall equipment availability, the Canadian Forces have nevertheless continued to demonstrate their ability to put effective, combat-capable forces into the field on a regular basis.

The Department and the Canadian Forces recognize the need to manage readiness and are committed to developing reporting systems that provide meaningful, readiness-related information to assist decision making at all levels. Further development of these reporting systems will take the Auditor General's recommendations into consideration.

10.128 Recommendation. As well as fully implementing such systems as MASIS to address its long-standing needs in maintenance management, the Department should take interim steps to improve its ability to manage in both the short and the long terms. These interim steps should include ensuring that adequate information is available on equipment readiness and maintenance; and auditing or otherwise validating the information in its maintenance management information systems.

Department's response. The Department recognizes the short-term need to ensure that our many maintenance management information systems provide adequate information on equipment readiness and maintenance. National Defence will continue to enhance interim steps to guarantee the reliability of information contained in maintenance legacy systems. The Department's priority remains firmly with the full implementation of the MASIS system. Part of this implementation is the requirement to validate the Department's existing Maintenance Management Information Systems (by environment), to ensure the integrity of data transferred to MASIS. The Department will accelerate the validation of the information in its maintenance management information systems. This will assist in the transition to MASIS and in long-term environmental rollouts and improve our ability to manage equipment readiness and maintenance in the short and long terms.

10.129 Recommendation. The Department should enforce the requirement to complete post-exercise and post-deployment reports.

Department's response. The Department is pursuing ways and means of improving post-exercise and post-deployment reporting with a focus on strategic-level exercises and deployments. A key enabler will be the development of a strategic-level lessons learned database. It should be noted that certain of the military environments already have a well-developed and proven lessons learned database and dissemination process.

10.130 Recommendation. In its plans to improve recruiting and retention of military personnel, the Department should give high priority to equipment support occupations. On an urgent basis, it should rectify gaps in maintenance training .

Department's response. While the Canadian Forces recognizes it has difficulty attracting new recruits into some of its technical trades, it has taken several steps to correct the situation both in the short and in the long terms. To quickly improve the situation in the technical occupations, the Canadian Forces has targeted college-qualified personnel by offering significant recruiting allowances and enrolment at the Acting Corporal level, which offers a better starting salary. In addition, our advertising and marketing campaigns place special focus on the understrength technical occupations.

With respect to training gaps, it is acknowledged that a number of technical occupations have backlogs for specialty training. A concerted effort is now being undertaken by all Canadian Forces Technical Schools to reconcile this situation. However, it must be emphasized that the effect on operational readiness and capability is not as bleak as portrayed in this chapter. In most technical occupations, both on-the-job experience and specific specialty training are the two complementary prerequisites for specialization. This could take two to five years in many cases. During these periods, Canadian Forces technicians typically work in teams with qualified supervision to ensure that equipment and systems are properly maintained.

Overall, the Canadian Forces is addressing the challenges in recruiting, training, and retaining its technical personnel. The current shortages and training backlog do not affect our operational readiness and capability to undertake White Paper commitments. The comprehensive strategies that we have already implemented are focussed on resolving our current deficiencies as rapidly as possible.

10.131 Recommendation. The Department should address the problems of supplying high-priority spare parts to deployed units, as raised in end-of-tour reports, especially the problems in administrative functions such as shipping and transportation.

Department's response. The problems encountered in the supply of high-priority spare parts to support the operations of deployed units have been studied repeatedly since the Gulf War. To determine the appropriate supply levels of spare parts to be held at any given time in theatre is a difficult task, strongly influenced by factors such as equipment numbers, expected intensity of operations, climatic conditions, the length of the supply line back to Canada, the ready availability of national stocks, and the availability of CF aircraft and commercial transportation for resupply.

Notwithstanding the inherent difficulties in supplying spare parts to overseas theatres, the Department is committed to finding solutions. The process for supplying spare parts is being reviewed at a number of levels to determine where improvements can be made and to streamline the process. As part of the review, the demand for high-priority spare parts and the response times will be monitored. As well, direction for international operations will be reviewed to provide improved guidance to Task Force Commanders regarding the delivery of spare parts. The main thrust of the review will be to ensure that the appropriate support is in place to achieve each mission's individual requirements, with particular emphasis on high-priority demands.

About the Audit

Objectives

The overall objective of our audit was to determine whether major equipment platforms were maintained adequately by National Defence and the Canadian Forces. Specifically, we sought to do the following:

- assess the extent to which major equipment has been available to the troops for training and operations; and
- assess whether the Department has taken appropriate action to optimize the equipment availability rates of its major fleets.

Scope

Our audit focussed on the factors that affect the availability of major equipment that the Navy, Air Force, and Army need to achieve their missions and tasks namely, personnel qualifications, personnel shortages, and availability of spare parts. To the extent possible, we based our audit on the Department's own standards for equipment availability. We selected the following major equipment fleets:

- **Army**: Bison, Coyote, Grizzly, heavy logistic vehicle wheeled (HLVW), medium logistic vehicle wheeled (MLVW), based on the high usage of these vehicles.
- **Navy**: Halifax class frigates, Iroquois class destroyers, supply ships, and Maritime Coastal Defence Vessels, the main combat fleets. We excluded submarines because the Oberon class had been decommissioned and the Victoria class had not entered into service by the time of our audit.
- **Air Force**: CF–18 Hornet, Hercules, Aurora, Sea King, and Griffon, the main combat fleets.

The Department considers these vehicles to be its most important operational platforms.

We did not include contracted maintenance services in the scope of our audit.

Except in a few specific cases, the audit did not establish a correlation between the availability of spare parts and the availability of equipment to support operations.

We sought to identify factors that could explain limitations on availability (for example personnel shortages, qualifications, or spare parts) and assess the impact of gaps in availability over the last five years.

Trend analysis focussed on operational availability, sorties (Air Force), and activity rates of the three services. Maintenance hours per activity, maintenance costs per fleet, age of equipment, and national procurement funding were also assessed. We sought to analyze trend data in order to conclude what impact equipment maintenance had on the serviceability/availability of equipment, generally over a five-year period. We used various departmental databases during the course of our audit. It was not possible, given the scope of our audit, to completely validate the databases.

To assess human resource management, we judgmentally selected 36 maintenance military occupational classifications and a sample of 49 maintenance units to identify equipment related maintenance problems. Our selection was based on operationally deployable units and major third line repair depots. These units employed about 5,000 of 15,000 military maintenance personnel. We surveyed the selected maintenance units to collect data on personnel shortages and qualifications and to assess the overall impact this had on exercises and operations.

We reviewed departmental files, including post-exercise reports, departmental business plans and end of tour reports for international operations, in order to assess the impact of equipment maintenance deficiencies on the conduct of exercises and operations of the three services. In order to collect information, we visited the two Navy formations (Halifax and Esquimault), and the three operational brigades (1 Canadian Mechanized Brigade Group—Edmonton, 2 Canadian Mechanized Brigade Group—Petawawa, and Canadian Mechanized Brigade Group—Valcartier). We also visited various Air Force wings (1 Wing—Kingston, 8 Wing—Trenton, 12 Wing—Shearwater and Patricia Bay, 14 Wing—Greenwood, 17 Wing—Winnipeg, and 19 Wing—Comox).

Criteria

We expected that National Defence would do the following:

- have and meet its own standards for availability of major equipment fleets;
- develop and implement adequate maintenance systems to ensure the availability of targeted equipment;
- meet its targets for numbers of maintenance personnel and train them to its established standards; and
- have an adequate system to report to the Chief of the Defence Staff on the state of readiness of major equipment and on equipment maintenance problems.

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Report of the Auditor General of Canada to the House of Commons—2001

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Chapter 11

Illicit Drugs: The Federal Government's Role

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

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Chapter

11

Illicit Drugs

The Federal Government's Role

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Illicit Drugs
The Federal Government's Role

Main Points

11.1 Illicit drugs have a significant negative impact on Canada and on individual Canadians. They are a major source of funding for organized crime and for terrorism. The economic costs, including health care (for example, HIV/AIDS and hepatitis), lost productivity, property crime, and enforcement are estimated to exceed $5 billion annually. In 1999 there were over 50,000 persons charged with drug offences and an estimated 400,000 court appearances.

11.2 If Canada is to reduce the impact of illicit drugs, it will need to address weaknesses in leadership and co-ordination, information, and comprehensive public reporting. We found the following:

- Canada requires stronger leadership and more consistent co-ordination to set a strategy, common objectives, and collective performance expectations. It must be able to respond quickly to emerging concerns about illicit drug use or the illicit drug trade. The present structure for leadership and for co-ordination of federal efforts needs to be reviewed and improved. The mechanisms for co-ordination with the provinces and municipalities also need review since they cross three levels of government.
- Information on the extent of the drug problem is sparse, outdated, or not available. In addition, federal departments lack basic management information on illicit drug efforts, such as expenditures, objectives, and results.
- There is no comprehensive public reporting. No public report clearly explains what the federal government and other levels of government are doing to reduce the demand for and the supply of illicit drugs. Neither parliamentarians nor Canadians know the full extent of the illicit drug problem and the social, economic, and health costs associated with it.

Background and other observations

11.3 In 1992 the government approved Canada's Drug Strategy, a co-ordinated effort to reduce the harm caused by alcohol and other drugs. The strategy calls for a balanced approach to reducing both the demand for drugs and their supply through such activities as control and enforcement, prevention, treatment and rehabilitation, and harm reduction.

11.4 In 1997 the *Controlled Drugs and Substances Act* was introduced. It remains the current legislation for controlling the use of illicit drugs. Since 1997, most of the government's legislative changes related to illicit drugs have focussed on supply reduction (enforcement), not demand reduction.

11.5 To co-ordinate Canada's Drug Strategy, Health Canada chairs the co-ordinating groups: the Assistant Deputy Ministers' Steering Committee on Substance Abuse and the Interdepartmental Working Group on Substance Abuse.

11.6 Federally, 11 departments and agencies spend approximately $500 million annually to address illicit drug use in Canada. The main ones are Health Canada, the Department of Justice, the Royal Canadian Mounted Police, Solicitor General Canada, the Canada Customs and Revenue Agency, Correctional Service Canada, and the Department of Foreign Affairs and International Trade. In addition, municipal and provincial/territorial governments are equally involved in addressing illicit drugs.

11.7 Some other countries engaged in addressing the problem of illicit drugs emphasize the importance of strong leadership and up-to-date management information and comprehensive public reporting. Canada has not given it the same emphasis.

The government has responded. Health Canada, responding on behalf of the government, indicated that it will consider our recommendations but has not outlined any specific action.

Introduction

11.8 For centuries, humans have experimented with a variety of substances such as tobacco, alcohol, opium, and coca for a range of personal and cultural reasons. With the passage of time, some of these substances have become a major concern for Canada and are now defined as illicit substances.

11.9 "Illicit drugs" is a commonly used term that refers to certain substances listed under the 1997 *Controlled Drugs and Substances Act*. These substances include heroin, cocaine, cannabis (including marijuana and hashish), and synthetic substances such as LSD and ecstasy. The regulations under the Act outline the conditions under which certain drugs may be used for legitimate reasons, such as medical treatment. The regulations also set out the conditions under which the possession, production, and sale of such substances are illegal. Exhibit 11.1 provides an overview of both illicit and legal substances that can be abused.

Exhibit 11.1 Illicit and legal substances that can be abused

[illegible]	[illegible]	[illegible]
Tobacco	Cigarettes, cigars	Use in some public places, sale to minors
Alcohol	Wine, beer, spirits	Driving while intoxicated, sale to minors, use in prison
Substances covered by the *Controlled Drugs and Substances Act**	Heroin, LSD, cocaine, marijuana, ecstasy, medications such as antidepressants and tranquillizers, and sport enhancing substances such as anabolic steroids	Possession and trafficking of cocaine and heroin, medications obtained without a proper prescription from a physician, possession of a banned substance by an athlete, smuggling cocaine into the country aboard an aircraft, possession of proceeds from selling drugs illegally
Other substances	Inhalants such as model airplane glue and gasoline	Not illegal but very harmful when abused

*Use of many substances under the *Controlled Drugs and Substances Act* are legal under restricted circumstances, such as drugs prescribed by a medical physician, including most recently "medicinal" marijuana. Many can also be used legally, without a medical prescription, such as mild pain relief pills that are available over the counter and contain low dosages of codeine, a controlled substance.

Illicit drugs affect Canadians in many ways

11.10 One way to measure the extent of the problem is by the sales of illicit drugs. While estimates vary, the United Nations believes that the annual global sales of illicit drugs are between $450 billion and $750 billion. In Canada, the government's estimates of sales range from $7 billion to $18 billion.

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11.11 Another way to measure the problem is by its economic costs: these include costs to the health care system, lost productivity, drug enforcement costs, and property crime committed by drug addicts. The total economic costs in Canada are estimated to exceed $5 billion a year.

11.12 A third way to measure the impact of illicit drugs is by the effects of drug-related offences on the criminal justice system. In 1999 about 50,000 people were charged with offences under the *Controlled Drugs and Substances Act* in cases where the most serious offence was drug-related (see Exhibit 11.2, particularly for the first note). In that same year, we estimated that Canadian criminal courts heard 34,000 drug cases that involved more than 400,000 court appearances. About 19 percent of offenders in the federal correctional system are serving sentences for serious drug offences.

11.13 For the roughly 50,000 persons charged, 90 percent of the charges related to cannabis and cocaine. Cannabis accounted for over two thirds of the charges, and about half of all charges were for possession.

11.14 The severity of the impact of illicit drugs varies widely. For example, cannabis is less associated with property crime and severe health effects than cocaine. Drugs affect people from all walks of life. By far the most direct harm occurs in high-risk populations, such as injection drug users, street youth, and the inner city poor. An estimated 125,000 people in Canada inject drugs. Injection drug use is a major risk factor in the spread of HIV/AIDS and hepatitis. In 1999 it resulted in an estimated 34 percent of all new HIV infections.

11.15 Illicit drugs are associated with a range of crimes, including break and enter, robbery, car theft, prostitution, and murder. Illicit drug users may commit a variety of crimes to fund their drug habits. In Vancouver, for example, an estimated 70 percent of criminal activity is associated with illicit drugs. About 63 percent of federal offenders have drug abuse problems.

Exhibit 11.2 Number of persons charged for offences under the *Controlled Drugs and Substances Act* in Canada during 1999

Substance	Possession	Trafficking	Importation	Cultivation	Total	Percentage
Heroin	351	800	23	–	1,174	2
Cocaine	3,375	6,990	184	–	10,549	21
Other drugs	1,797	1,561	157	–	3,515	7
Cannabis	21,381	8,112	157	4,697	34,347	70
Total	26,904	17,463	521	4,697	49,585	100
Percentage	54	35	1	10	100	

Note. Data report number of persons charged by most serious offence in a given incident. For example, if a person was charged with armed robbery and possession of a small quantity of drugs at the same time, the drug charge would not show up in the above figures. This prevents double counting of the number of persons charged.

"Number of persons charged" means persons charged by police or persons whom the police recommended that charges be laid against.

Source: Statistics Canada, Canadian Centre for Justice Statistics, Uniform Crime Reporting Survey

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Source: Statistics Canada, Canadian Centre for Justice Statistics, Uniform Crime Reporting Survey

11.16 A major concern in Canada is the relationship between drugs, organized crime, and violence. A 1998 federal government study of organized crime concluded that the drug trade has a significant impact on Canadians and entails substantial violence. Furthermore, with drugs as its primary source of revenue, organized crime has intimidated police officers, judges, juries, and correctional officers. Such intimidation is a direct threat to Canada's philosophy of peace, order, and good government. Of note is that more than 150 deaths since 1994 have been attributed to "biker" wars in Quebec over control of organized crime, including the illicit drug trade.

11.17 Illicit drugs also represent a source of income for terrorist groups. The United Nations has expressed deep concern about the links between terrorist groups and illicit drug production and trafficking.

11.18 Canada participates actively in international activities aimed at illicit drugs. It is chair of the Multilateral Evaluation Mechanism working group of the Inter-American Drug Abuse Control Commission of the Organization of American States. It is also an elected member of the Commission on Narcotic Drugs, the governing body of the United Nations International Drug Control Programme. Canada collaborated with the Commission and member states to develop a "Declaration on the Guiding Principles of Drug Demand Reduction" as well as an action plan to implement the principles.

11.19 Like the efforts of other Western nations, Canada's efforts have received both positive and negative assessments internationally. Canada was slow to regulate chemical "precursors" (chemicals used to produce illicit drugs such as ecstasy). It is viewed as both a supply and a transit country for illicit drugs. Recently, the United Nations International Narcotics Control Board raised some concern about Canada's efforts to eradicate cannabis. British Columbia's Organized Crime Agency estimates that more than 15,000 growing operations in British Columbia produce $6 billion worth of marijuana annually. The law enforcement community believes that a significant portion of this is smuggled to the United States; however, Canada supplies only a small portion of the U.S. market.

How Canada has dealt with the drug issue

11.20 Few restrictions on drug use existed until Canada passed its first drug legislation in 1908—the *Opium Act*. Since then, several pieces of legislation have been enacted to deal either directly or indirectly with illicit drug use in Canada. Legislation has expanded the list of illicit substances and increased federal enforcement powers to combat the problem. However, despite all the legislation and the resulting changes, there has been a growing acknowledgement by Canadians and parliamentarians that there are limits on the ability of law enforcement to reduce the supply of drugs.

11.21 In 1987 the federal government announced the National Drug Strategy. It was an effort to promote a "balanced approach" to dealing with both the demand for drugs and their supply in Canada. The strategy is balanced between prevention and education on the one hand and enforcement on the other. The strategy was intended to raise awareness and educate the public about the problems associated with substance abuse, improve the availability and accessibility of treatment and rehabilitation, strengthen enforcement and control, co-ordinate national efforts, and increase co-operation with international organizations.

11.22 From 1987 to 1992, the National Drug Strategy had $210 million in new funding to enhance existing programs and fund new initiatives, not only federally but also provincially. Some 70 percent of the funds were directed at education, prevention, and treatment—priority areas under the leadership of what was then Health and Welfare Canada. The strategy focussed mainly on school-aged youth.

11.23 In 1988 Parliament created the Canadian Centre on Substance Abuse (CCSA) as Canada's national non-government organization on addictions. It was one way the federal government tried to encourage co-operation among all levels of government and other partners. The CCSA provides a focus for reducing the health, social, and economic harm associated with substance abuse and addictions. Its primary responsibility is to provide credible, objective information and policies on addiction to the federal government, the not-for-profit and private sectors, and provincial/territorial and municipal governments. Today, Health Canada provides CCSA with $500,000 annually in core funding.

11.24 In November 1990, a secretariat was established in Health and Welfare Canada to co-ordinate activities within the federal government and with other governments at home and abroad. It was to work closely with the Canadian Centre on Substance Abuse.

11.25 In 1992 the government merged the National Strategy to Reduce Impaired Driving with the National Drug Strategy. The result was called Canada's Drug Strategy. The strategy was a co-ordinated effort to reduce the harm caused by alcohol and other drugs. Its focus was expanded to include prevention, treatment and rehabilitation, information and research, and enforcement and control. Targeted populations included not only mainstream youth but also children at risk (abused youth, dropouts, street kids, the unemployed, and off-reserve Aboriginal youth). Funding for the strategy was $270 million over five years. This was in addition to what was already being spent on drug-related measures.

11.26 To co-ordinate the strategy, Health and Welfare Canada chaired two new co-ordinating groups: the Assistant Deputy Ministers' Steering Committee on Substance Abuse and the Interdepartmental Working Group on Substance Abuse. The Steering Committee is mandated to meet at least twice a year to improve the overall effectiveness of the strategy and provide direction to the Working Group. Its aims are to co-ordinate federal activities, develop consensus on priorities, address emerging issues, and monitor implementation of the federal strategy.

11.27 In 1997 the government introduced the *Controlled Drugs and Substances Act*, the current legislation for controlling the use of illicit drugs. In 1998 Canada's Drug Strategy was renewed in principle but without funding.

Although it was called Canada's Drug Strategy, its signatories were limited to federal departments and agencies. Health Canada's role again was to provide national leadership and co-ordination of the renewed strategy. The Department was to conduct research, disseminate leading-edge information and best practices to key partners, and collaborate with multilateral organizations to address the global drug problem. Currently, proposals are being developed to renew the strategy.

11.28 The strategy's long-term goal is still to reduce the harm to society associated with alcohol and other drugs. It continues to emphasize a balance between reducing the demand for and the supply of drugs. Its objectives include the following:

- reducing the demand for drugs;
- reducing drug-related mortality and morbidity by reducing high-risk behaviours, such as spreading HIV/AIDS through needle sharing;
- improving the effectiveness of and accessibility to substance abuse information and interventions;
- restricting the supply of illicit drugs;
- reducing the profitability of illicit drug trafficking; and
- reducing the costs of substance abuse to Canadian society.

11.29 Since 1997, most of the federal government's changes to legislation relevant to illicit drugs have focussed more on reducing supply (enforcement) than reducing demand. For example, the Canadian *Criminal Code* was amended to include organized crime offences, and the government created the Financial Transactions and Reports Analysis Centre of Canada to monitor financial transactions in order to detect and deter money laundering. In 2000, legislative control measures came into effect for some psychotropic substances covered by the 1971 UN Convention on these substances.

Focus of the audit

11.30 Our examination focussed on the federal government's role in the illicit drug portion of Canada's Drug Strategy. The objectives of our audit were to determine whether the federal government has the following in place:

- adequate information on the extent of the problem as well as the information required to manage its activities;
- comprehensive public reporting on objectives and results; and
- clear leadership and co-ordination.

11.31 The audit did not examine the role played by provinces, municipalities, and non-government organizations. Their involvement is substantial. Details on the objectives, scope, and criteria can be found at the end of the chapter in About the Audit.

Observations

Addressing illicit drugs

The federal infrastructure

11.32 All levels of government—federal, provincial/territorial, and municipal—are involved in Canada's efforts to reduce the harm and availability of illicit drugs. At the provincial/territorial and municipal levels, these include efforts in health, corrections, social services, and courts, and by prosecutors (Quebec only) and police forces. For example, provincial and municipal police forces and courts handle the majority of illicit drug cases. The international community and non-government organizations, such as the Canadian Association of Chiefs of Police and the Canadian Federation of Municipalities, also play important roles.

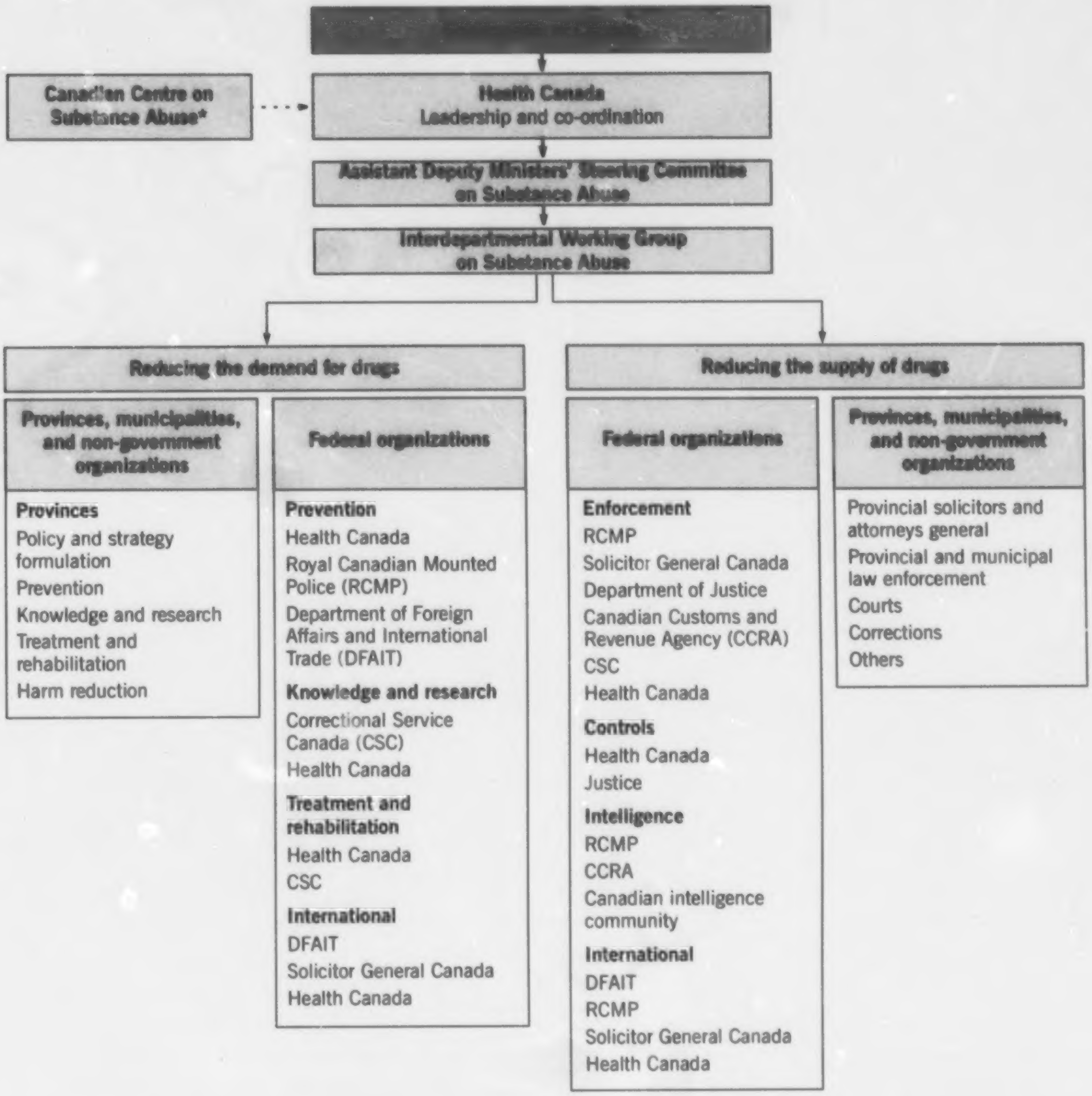
11.33 Federally, 11 departments and agencies are involved in addressing illicit drug use in Canada. The main ones are Health Canada, Solicitor General Canada, the Royal Canadian Mounted Police (RCMP), the Department of Justice, the Canada Customs and Revenue Agency, Correctional Service Canada, and the Department of Foreign Affairs and International Trade (Exhibit 11.3). The Canadian Centre on Substance Abuse also plays a key role.

11.34 **Health Canada.** Health Canada provides the leadership and co-ordination for Canada's Drug Strategy. It chairs both the Assistant Deputy Ministers' Steering Committee on Substance Abuse and the Interdepartmental Working Group on Substance Abuse. It also sits on a number of committees, in the following capacities:

- Chair, Federal/Provincial/Territorial Committee on Alcohol and Other Drug Issues;
- Co-Chair, Federal/Provincial/Territorial Committee on Injection Drug Use;
- Alternate Head, Canadian delegation to the United Nations Commission on Narcotic Drugs;
- Member, Canadian Association of Chiefs of Police Drug Abuse Committee; and
- Member, Federal/Provincial/Territorial Deputy Minister Steering Committee for Health and Enforcement Partnership.

11.35 Health Canada is also involved directly in activities to reduce the demand for and the supply of illicit drugs. Its Office of Controlled Substances is responsible for the legislative control framework to control illicit drugs. The office administers the regulations of the *Controlled Drugs and Substance Act,* which includes processing the licensing and permit requirements for the use of controlled substances for legitimate purposes. The Office of Cannabis Medical Access deals with controls on the medical use of marijuana. The Office of Canada's Drug Strategy manages a $15.5 million annual contribution program that provides funding for alcohol and drug treatment programs. The same program also provides funding to the Canadian Centre for Substance Abuse. The Drug Analysis Service provides a laboratory service to the Canadian law enforcement community to test seized drugs.

Exhibit 11.3 Canadian infrastructure for dealing with illicit drugs


[redacted]
Canadian Centre on Substance Abuse*
Health Canada
Leadership and co-ordination
Assistant Deputy Ministers' Steering Committee on Substance Abuse
Interdepartmental Working Group on Substance Abuse
Reducing the demand for drugs
Provinces, municipalities, and non-government organizations
Provinces
Policy and strategy formulation
Prevention
Knowledge and research
Treatment and rehabilitation
Harm reduction
Federal organizations
Prevention
Health Canada
Royal Canadian Mounted Police (RCMP)
Department of Foreign Affairs and International Trade (DFAIT)
Knowledge and research
Correctional Service Canada (CSC)
Health Canada
Treatment and rehabilitation
Health Canada
CSC
International
DFAIT
Solicitor General Canada
Health Canada
Reducing the supply of drugs
Federal organizations
Enforcement
RCMP
Solicitor General Canada
Department of Justice
Canadian Customs and Revenue Agency (CCRA)
CSC
Health Canada
Controls
Health Canada
Justice
Intelligence
RCMP
CCRA
Canadian intelligence community
International
DFAIT
RCMP
Solicitor General Canada
Health Canada
Provinces, municipalities, and non-government organizations
Provincial solicitors and attorneys general
Provincial and municipal law enforcement
Courts
Corrections
Others

*The Canadian Centre on Substance Abuse was established by an Act of Parliament but operates independently of the government. It is managed by a Board of Directors appointed by the Governor in Council.

11.36 **Solicitor General Canada.** The Solicitor General plays a leadership and co-ordinating role in policing, security, and corrections under Canada's Drug Strategy. The Department is also engaged in related activities both domestically and internationally, including the following:

- Chair, Inter-American Drug Abuse Control Commission's (CICAD) Multilateral Evaluation Mechanism working group;
- Chair, Interdepartmental Committee of Assistant Deputy Ministers on Public Safety;
- Chair, National Co-ordinating Committee on Organized Crime;
- Co-chair, Canada/U.S. Cross-Border Crime Forum;
- Co-chair, Federal/Provincial/Territorial Deputy Minister Steering Committee on Organized Crime; and
- Participation with provinces and municipalities in the Federal/Provincial/Territorial Deputy Minister Steering Committee for Health and Enforcement Partnership.

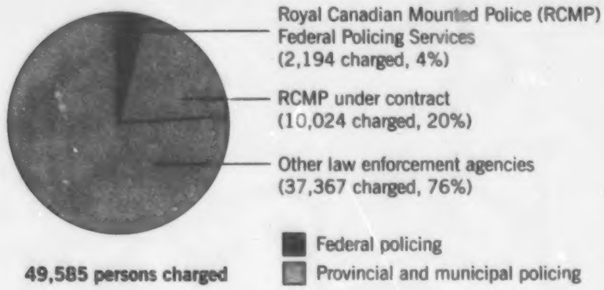
11.37 **RCMP.** The RCMP's federal drug efforts focus on such activities as seizing drugs, investigating and arresting the upper echelon of criminal organizations involved in the drug trade, and seizing proceeds of crime. The RCMP also undertakes drug enforcement as part of the provincial and municipal policing responsibilities it performs on contract.

11.38 The RCMP's federal drug efforts are largely undertaken by two groups: Drug Enforcement Branch, with about 886 staff; and the Integrated Proceeds of Crime Initiative, with about 415 staff. The latter group investigates persons for proceeds of crime and seizes assets obtained through illicit drug sales. These two groups receive significant assistance from RCMP functions such as intelligence and other specialized investigation services, including electronic and physical surveillance. Other RCMP groups, such as the Customs and Excise Branch and Federal Statute Enforcement, also make a number of drug-related arrests; however, those arrests are generally incidental to the primary focus of their activities.

11.39 Of the 50,000 people charged in Canada in 1999 for offences under the *Controlled Drugs and Substances Act*, where a drug offence was the most serious offence, an estimated four percent were charged by the RCMP in its federal role. Exhibit 11.4 shows who laid drug charges in 1999.

11.40 The RCMP has adopted a more strategic, intelligence-driven approach. It now sets national priorities based on threat assessments so that resources will be focussed on the areas of greatest risk to Canadians. Resources currently target the upper echelon of organized crime. This approach has resulted in cases that are complex and lengthy and consume significant resources. It requires extensive partnerships with other police forces both within and outside Canada.

Exhibit 11.4 Charges under the *Controlled Drugs and Substances Act* in 1999



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"Number of persons charged" means persons charged by police or persons whom the police recommended that charges be laid against.

Source: Statistics Canada and the RCMP

11.41 The RCMP participates in many "joint force operations" aimed at combatting organized crime. Some of these operations are permanent working groups, while others are temporary and aimed at a specific target. The RCMP estimates that it has assigned about 900 staff to these operations, including many from its Federal Drug Enforcement Branch. The case study on page 12 provides an example of one partnership project.

11.42 Integrated Proceeds of Crime is a federal initiative whose mandate is to investigate organized crime groups, with a view to seizing/restraining and forfeiting assets gained through criminal activities. It is largely a drug-related initiative; an estimated 90 percent of seizures are related to drugs. The initiative consists of 13 units across Canada, staffed with a mix of federal, provincial, and municipal police; Justice counsel; Customs officers; tax investigators; asset managers; and forensic accountants. The cases are complex and lengthy because organized crime launders its funds through a web of accountants, lawyers, and seemingly legitimate businesses that often cross jurisdictional boundaries. The RCMP reported in its 1999–2000 *Performance Report* that the value of assets seized was $32 million.

11.43 The RCMP also delivers drug prevention programs. It makes some 8,000 presentations annually to students, parents, employees, and community groups. Both RCMP federal and contract policing personnel participate using programs such as "Drugs and Sport."

11.44 **Department of Justice.** The Department of Justice prosecutes drug cases and provides expertise to the development of legislation addressing organized crime. It has a pilot initiative, the Toronto Drug Treatment Court Program, that offers alternatives to traditional prosecution.

Airline employees arrested in drug importation ring

The Toronto Airport Drug Enforcement Unit has dismantled an alleged internal conspiracy involving the importation of illegal drugs through Toronto's Lester B. Pearson Airport. This criminal network included six staff operating within Air Canada ground service personnel. They used their positions of employment and access of areas in the airport to smuggle into Canada drugs hidden aboard aircraft. Ten people were arrested for conspiracy and importation of illegal drugs.

During the 11 month investigation, the unit seized 40 kilograms of cocaine, 40 kilograms of hash oil, and 20 kilograms of hashish. During today's searches and arrests, additional drugs and a loaded firearm were seized.

The investigation team consisted of the RCMP, Toronto Police Service, Ontario Provincial Police, Peel Regional Police, and the Canada Customs and Revenue Agency, with co-operation from Air Canada.

Source: Royal Canadian Mounted Police press release (29 November 2000)

11.45 The Federal Prosecution Service (FPS) prosecutes drug cases, including proceeds of crime cases that are initiated by municipal and provincial police or the RCMP (on contract or in its Federal Policing Services). In Quebec, the FPS prosecutes only cases where the RCMP has laid charges.

11.46 The Federal Prosecution Service includes over 300 in-house counsel and nearly 800 private sector counsel appointed as agents of the Crown. They prosecute under a range of federal statutes, but drug prosecutions constitute most of their work. The ability of the FPS to provide high-quality prosecution services is a major factor in determining whether the police efforts will end in success or failure. Most cases are of low or medium complexity; however, the complexity of cases is increasing and complex cases are becoming more common. Currently, it is estimated that complex cases make up 7 percent of the caseload but use 60 percent of prosecutors' time. Complex organized crime cases require the involvement of Justice at an early stage because of the legal issues associated with the collection, organization, and admissibility of evidence.

11.47 **Canada Customs and Revenue Agency.** Canada Customs and Revenue Agency contributes to reducing the supply of illicit drugs in two ways. Customs intercepts illicit drugs entering Canada at our borders. For instance, it estimates that in 1999 it seized illicit drugs with a street value estimated at $351 million (Exhibit 11.5). The seizures are attributable to its own efforts and police information. For example, between 1986 and 1999, the RCMP provided intelligence that led to 45 cocaine seizures, representing 18 percent of the total quantity of cocaine intercepted in that period. Taxation audits individuals suspected of selling illicit drugs or engaging in other illegal activities and raises assessments and levies penalties where it finds unreported income. Taxation also investigates suspected tax evasion and recommends prosecution of individuals.

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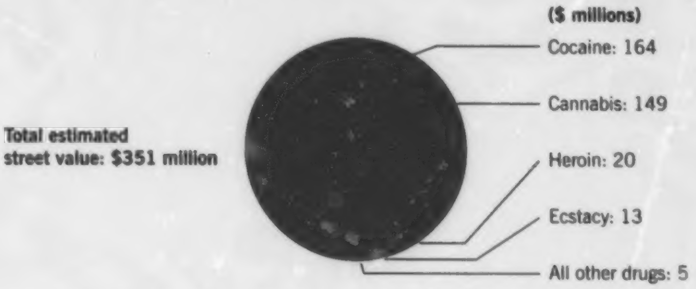
Exhibit 11.5 Street value of Canada Customs and Revenue Agency's drug seizures in 1999



Source: Canada Customs and Revenue Agency

11.48 **Correctional Service Canada.** Correctional Service Canada (CSC) is responsible for offenders serving criminal sentences over two years. These include individuals convicted of serious drug offences. CSC provides substance abuse and treatment programs to offenders with drug problems. It also uses security measures, including the use of sniffer dogs and urinalysis testing, to control the supply of illicit drugs in prisons.

11.49 The largest cost of CSC is incarceration. The most serious offence by 17 percent (3,400) of its offenders is drug-related. CSC estimates that about 7 percent of its offenders are associated with organized crime.

11.50 Substance abuse is one of seven criminogenic factors contributing to criminal behaviour. Nearly two thirds of offenders entering the federal corrections system have drug abuse problems. An estimated 53 percent of offenders participate in substance abuse programs while serving their sentences.

11.51 In addition to substance abuse programs, CSC has provided methadone treatment to some opiate-addicted injection drug users. Injection drug users pose a serious problem for institutions as they can contribute to the spread of HIV/AIDS and hepatitis. As a harm reduction measure, CSC also makes bleach available in prisons to sterilize needles shared by inmates.

11.52 **Department of Foreign Affairs and International Trade.** Foreign Affairs and International Trade collaborates with other federal departments and represents Canada in the international aspects of Canada's Drug Strategy. The Department manages Canada's monetary contributions to the United Nations International Drug Control Programme and the Inter-American Drug Abuse Control Commission of the Organization of American States. The allocation of this funding to projects is co-ordinated by an interdepartmental committee of federal departments and agencies chaired by the Department.

Need for information

11.53 Managing the illicit drug problem in Canada is inherently difficult. It requires the efforts of three levels of government—federal, provincial/territorial, and municipal—and many non-government organizations. It also requires the balancing of two different approaches: reducing the demand for illicit drugs and their supply. Achieving this balance means integrating the work of all players involved in enforcement, prevention, treatment and rehabilitation, and harm reduction. Although integrating the efforts of three levels of government is difficult, it is essential.

11.54 To achieve an appropriate degree of integration, three things need to be in place:

- adequate information on the extent of the problem as well as information required to manage its activities;
- comprehensive public reporting on results; and
- clear leadership to co-ordinate the activities of all the players and to maximize the effectiveness of Canada's efforts to combat illicit drugs.

11.55 Our biggest obstacle to conducting this audit was the lack of data. We found that data were sparse, often outdated, not available, or located in a myriad of diverse sites.

Total federal resources are not known

11.56 The most basic information needed to effectively manage any program is the amount of resources expended. The federal government could not provide complete information on resources spent to address illicit drugs. Part of the difficulty is understandable. Many departments do not keep data from an illicit drug perspective. For example, Correctional Service Canada does not normally break down its incarceration costs by type of offence.

11.57 Building on the information that some agencies were able to provide, we undertook to piece together an estimate of federal expenditures in 1999–2000 (Exhibit 11.6).

11.58 Our estimate excludes programs that do not spend a significant amount of resources on addressing illicit drugs and programs for which it was difficult to make even a rough estimate. For example, we excluded Health Canada's National Native Alcohol and Drug Abuse Program that spends about $80 million annually on substance abuse treatment and prevention for on-reserve Aboriginal people. Health Canada stated that most of those resources were used in the prevention and treatment of alcohol abuse. Another program with costs potentially related to illicit drugs is Health Canada's HIV/AIDS program; its annual funding is $42 million to support activities such as surveillance and community-based prevention initiatives. This program was excluded because we could not estimate the portion of this program that addresses illicit drugs; however, in 1999 an estimated 34 percent of all new HIV infections arose from injection drug use.

11.59 Employability Assistance for People with Disabilities, a program of Human Resources Development Canada (HRDC), focusses primarily on employability but has provided some support for substance abuse treatment in past years. The program spends about $189 million annually, but we could not estimate how much of that is for substance abuse treatment because the Department lacks information on how the funds are used. Another program funded by HRDC, the Homeless Initiative announced by the government in 1999, includes projects that address substance abuse among the homeless. However, we did not include the program in our estimate because its spending in 1999–2000 was not significant.

11.60 About 95 percent of the federal government's expenditures that address illicit drugs were used for supply reduction (enforcement or interdiction). The RCMP, Correctional Service Canada, and the Department of Justice spent most of the money (Exhibit 11.6). The federal government's expenditures on enforcement reflect its role in supply reduction; the federal role in reducing the demand for illicit drugs is less clear. Federal expenditures that address illicit drugs also benefit other federal priorities. For example, expenditures on drug enforcement benefit the government's organized crime priorities.

11.61 What the provinces, territories, and municipalities are spending to reduce the demand for illicit drugs and their supply is not known.

Law enforcement statistics need improvement

11.62 There are weaknesses in some aspects of law enforcement statistics. First, there are no national statistics on illicit drug convictions and sentencing. For example, British Columbia, Manitoba, New Brunswick, and Nunavut do not provide adult criminal court data to Statistics Canada. The use of statistics requires good analysis and interpretation to understand underlying trends and causes. Because Canada does not have national data, it cannot monitor important trends such as sentence lengths, emergence of new drugs, and regional differences. For example, because of the large number of persons charged for possession, there is a popular belief that individuals are being targeted for just possession. However, a limited RCMP study found that a significant proportion of possession cases were a consequence of police intervention for other matters, such as driving offences.

11.63 A second weakness is that the statistics on drug convictions and sentencing, which are reported according to the categories under the *Controlled Drugs and Substances Act*, are limited in detail. While the national statistics on police charges break down the number of drug charges by both type of substance (for example, heroin, cocaine, and cannabis) and act (for example, possession, trafficking, importation, and cultivation), the statistics on convictions are broken down into only two categories—possession and trafficking. The Inter-American Drug Abuse Control Commission's 1999–2000 report on Canada's progress in drug control stated that improvements were needed in the justice system's statistics on drug offences.

11.64 A third area that needs improvement is information on illicit drug seizures. A 1998 study by Solicitor General Canada found that only partial figures are available on drugs seized in Canada by law enforcement agencies.

Exhibit 11.6 Estimated federal expenditures that address illicit drugs for 1999–2000

Department or agency	Activities	Estimated 1999–2000 expenditures ($ millions)		
		Supply reduction	Demand reduction	Total
Canadian Centre on Substance Abuse	Promotes drug awareness, harm reduction, effectiveness of programs, and development and exchange of information.		1	1
Canada Customs and Revenue Agency	Intercepts illicit drugs and drug traffickers at the Canadian border.[1]	14 to 36	–	–
	Administers Special Enforcement Program aimed at people profiting from illegal activities.[2]	(4)	–	10 to 32
Canadian Institutes of Health Research	Funds research projects on addiction.		1	1
Correctional Service Canada	Deals with offenders serving sentences in whole or part for drug-related offences.[3]	154		
	Administers substance abuse programs, including alcohol.		8	
	Administers treatment programs (for example, methadone).		4	
	Conducts urinalysis testing.	3		
	Undertakes security measures to control supply in institutions.	Unknown		169
Department of Foreign Affairs and International Trade	Manages Canada's international drug activities, including contributions to the United Nations Drug Control Program and the Inter-American Drug Abuse Control Commission.	1	1	2
Department of Justice	Prosecutes drug offences.	56		
	Provides legal aid and contributions to provinces and territories for juvenile justice services ultimately used for drug cases.	14		
	Carries out projects (by its National Crime Prevention Centre) focussed on alcohol and drug abuse.		1	71
Health Canada	Provides laboratory analysis services to the police to test suspected seized drugs.	5		
	Administers controlled drug legislation, including import-export licence responsibilities.	2		
	Makes contributions under the $15.5 million "Alcohol and Drug Treatment and Rehabilitation Program" (ADTR). Our estimate of the illicit drug portion is $7 million.		7	
	Co-ordinates Canada's Drug Strategy and manages the ADTR program.		1	15

Exhibit 11.6 (Continued)

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
National Parole Board	Makes parole decisions on offenders sentenced for serious drug offences.	4		4
Public Works and Government Services Canada	Manages assets seized by law enforcement and distributes residual proceeds upon disposal.[4]	(10)		(10)
Royal Canadian Mounted Police (Federal Policing Services)	Focusses on large-scale trafficking and importation cases involving organized crime, seizure of assets from proceeds of crime, and intelligence and specialized services such as physical and electronic surveillance. Participates in joint force operations that are both ad hoc and permanent.	164		
	Administers drug awareness programs.		4	168
Solicitor General Canada	Administers policy, conducts research, and co-ordinates enforcement activities.	1	–	1
	Total	**404 to 426**	**28**	**432 to 454**

[1] Because the Agency's illicit drug interdiction work is highly integrated with its other activities, the estimate is presented as a likely range within which the cost of drug interdiction falls. This represents between four and eight percent of its 1999–2000 expenditures totalling $464 million.

[2] The figure shown is assessed taxes and fines net of investigation costs.

[3] This estimate covers all aspects associated with drug offenders incarcerated and under community supervision, including both direct and indirect costs.

[4] The figure shown is the federal government's share of revenue generated from the disposal of assets seized from the drug trade net of costs incurred by the Department to manage the assets. The total federal government's share of revenue net of costs was $10 million. RCMP investigation and Department of Justice prosecution costs, which total over $40 million annually, are not included in this figure.

11.65 The Canadian Centre for Justice Statistics produces regular reports on the key components of the justice system in Canada, including data on policing, courts, and corrections. It also produces analytical reports to respond to priorities of the justice community. The products and priorities of the Centre are determined by the National Justice Statistics Initiative—a partnership of the federal, provincial, and territorial ministries responsible for justice. The Centre last produced a stand-alone report on illicit drugs in 1999, based on statistics up to 1997.

Information on the drug problem in Canada is weak

11.66 Canada does not know either the size of the illicit drug problem or how it is changing. The most recent national estimate was a 1996 study that estimated what the economic costs of illicit drugs had been in 1992. Much has changed since then. The growing influence of organized crime, the spread of HIV/AIDS and hepatitis C, the emerging popularity of drugs such as ecstasy, and the increased marijuana production in B.C. have all affected the illicit drug problem. The 1996 study did not capture all significant costs. For example, it did not include the costs of property crime—that is, theft to fund drug use—believed to amount to billions of dollars annually. Another area

Exhibit 11.6 (Continued)

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11.67 No national survey has focussed specifically on drug use since the 1994 Canada's Alcohol and Other Drugs Survey; nor is one scheduled in the near future. The Canadian Centre for Substance Abuse annually produces *Canadian Profile: Alcohol, Tobacco and Other Drugs*, drawing data from a variety of sources to describe rates, patterns, and consequences of alcohol, tobacco, and other drug use. On some topics, there has been little or no new information since 1994.

11.68 Information is needed on the root causes of drug abuse, since it is rarely an isolated problem. Knowledge of particular high-risk groups is also limited. One of the most significant gaps is in information on illicit drug use on Native reserves; there is virtually no such information. A 1998 evaluation of Health Canada's National Native Alcohol and Drug Abuse program recommended that a task force be established to examine the problem, but no action was taken. Similarly, little is known about the nature, extent, and consequences of new drugs such as ecstasy or about some particular groups, such as homeless Canadians.

11.69 Other countries appear to have done better at collecting information. Australia, for example, has had its Illicit Drug Reporting System in effect for the last five years. This system provides periodic information on the following:

- the current availability, price, and purity of illicit drugs;
- patterns of illicit drug use;
- changes in the use of illicit drugs; and
- perceived drug-related health issues associated with new patterns of drug use.

The federal government has not set clear objectives

11.70 To achieve the desired results of any program, government must set clear and measurable expectations or objectives. Our review of departmental performance reports indicates that few reports state such expectations or concrete objectives.

11.71 The overall goal of Canada's Drug Strategy is to reduce harm to society. One measure of harm to society is the estimated societal costs associated with illicit drugs. As already noted, neither the amount currently spent to address illicit drugs nor how this amount has changed over time is known. Since Canada has a "balanced" strategy, it is important that there be clear goals for the balance it is seeking and clear indicators of what it is achieving.

11.72 A wide range of measurable targets can be used to state expectations (the expected results) for programs to reduce demand. The following are some examples:

- Increase the average age of new users to X in Y years.
- Reduce the number of drug overdose deaths by X percent in Y years.
- Decrease the proportion of inmates testing positive for drugs to X in Y years.

- Reduce the transmission of HIV/AIDS and hepatitis C from needle sharing by X percent in Y years.
- Increase the number of school boards by X percent that have implemented, tested, and evaluated drug programs.
- Increase by X percent the proportion of youth who report that they disapprove of ecstasy use.

11.73 Similarly, in the area of enforcement, measurable expectations could include the following:

- Increase proceeds of crime seizures by X percent in Y years.
- Dismantle X percent of targeted criminal organizations.
- Arrest and prosecute X percent of individuals targeted.
- Destroy X amount of marijuana through crop eradication.
- Seize X amount of heroin.
- Make X progress in implementing UN Convention Y.

11.74 Some other countries' strategies against illicit drugs have set measurable expectations. For example, the United Kingdom expects to reduce drug reoffences by 50 percent by 2008. The United States has set a target of a 25 percent reduction in the health and social consequences of illicit drugs by 2007. These countries have developed goals, targets, and indicators to measure progress both at the national level and by individual organizations.

Departmental reports lack information on results

11.75 An organization needs to be able to measure and report its results to determine whether it is making progress. Measuring results is also essential in deciding to allocate funds among different or competing initiatives. For departments that participate in Canada's Drug Strategy, understanding the results they have achieved is a key step in deciding on the appropriate balance between efforts to reduce the demand for drugs and efforts to reduce the supply.

11.76 The performance reports of individual departments say little about how their activities have contributed to the federal effort in combatting illicit drugs. They do not all specify, or clearly specify, what their strategy is, what they expect to achieve, and how much they are spending to reduce demand or supply. Similarly, their reports fail to indicate whether their strategies are working, and whether they are adjusting them in response to changing circumstances or are reallocating resources to more cost-effective interventions.

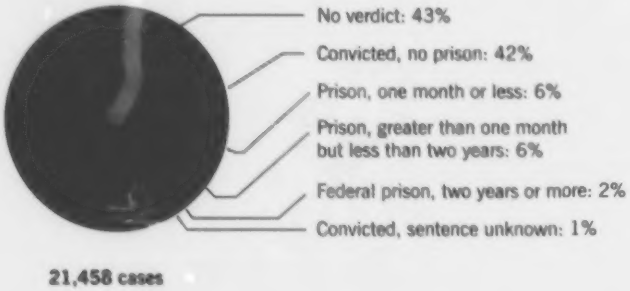
11.77 The RCMP's *Performance Report*, for example, provides minimal information on illicit drug activities carried out by its Federal Policing Services. While the RCMP has a strategy to target the upper echelons of organized crime that control the drug trade, it does not report what it has achieved in fighting organized crime. Its *Performance Report* provides little information on whether the supply of certain drugs is increasing or decreasing. One reason for these weaknesses in external reporting is that the RCMP is still developing good information for internal management.

11.78 We also feel that some of the information on Federal Policing Services in the RCMP's *Performance Report* is not explained well and does not reflect accomplishments. For example, in 1999–2000 the RCMP reported that it had investigated 38,515 drug offences. But the majority of these offences were investigated by its provincial and municipal policing activities and not its Federal Policing Services. As a result, it is not possible to get a clear picture of what its federal policing drug activities accomplished.

11.79 Similarly, the *Performance Report* of the Department of Justice does not indicate how well the Department is performing its key role in prosecuting drug and proceeds of crime cases. Although the Department expends considerable resources on prosecutions, its *Performance Report* does not discuss any aspect of this key activity and its results.

11.80 There are no published data on the outcomes of federal prosecution efforts. However, there are data from seven provinces and one territory that cover both drug prosecutions by the federal Department of Justice and prosecutions undertaken by other levels of government (Exhibit 11.7). This exhibit shows that 14 percent of the cases received prison terms, 42 percent were convicted but received no prison term, and 43 percent resulted in no verdict. About 90 percent of no-verdict cases were stayed/withdrawn and the remainder were sent to Superior Court or had other court decisions. Justice's prosecution policy provides that a prosecutor can proceed with a case only if there is reasonable prospect of conviction and the public interest warrants a prosecution.

Exhibit 11.7 Outcome of adult court drug cases in 1999–2000 for some jurisdictions



Note: Statistics were not available for British Columbia, Manitoba, New Brunswick, and Nunavut.
A "case" may consist of a number of charges. A case is classified as a drug case if the most serious charge in the case is for a drug offence.

Source: Statistics Canada, Canadian Centre for Justice Statistics, Adult Court Survey 1999–2000

11.81 A review of the Department's Federal Prosecution Service in 2001 reported a lack of reliable data on activities. The review stated that the Prosecution Service lacks not only more sophisticated information such as costing data and assessments of case complexity but also elementary data such as a simple and reliable profile of its caseload. The review recommended that Justice make developing reliable data a priority.

11.82 The Prosecution Service states that it is finding it a challenge to meet the demand for its services, given both the quantity and the complexity of its cases. The gap between the demand for its services and its ability to meet the demand is expected to widen unless changes are made. However, until the Department develops better basic data and performance, it will be difficult to know what changes should be made.

11.83 We reviewed the departmental performance reports and the reports on plans and priorities of each department and agency involved in Canada's Drug Strategy. For the five main organizations, we rated the information on resources, objectives, and results as none, limited, and clear. Exhibit 11.8 summarizes our findings.

Exhibit 11.8 Assessment of departmental performance reports, 1999–2000

[illegible]	[illegible]	[illegible]	[illegible]
Royal Canadian Mounted Police (Federal Policing Services)	◓	○	◓
Canada Customs and Revenue Agency	○	○	●
Department of Justice	○	○	○
Correctional Service Canada	○	◓	◓
Health Canada (consolidated)	○	○	○

● Clear information ◓ Limited information ○ No information

Comprehensive reporting

Canada does not know how well it is managing illicit drugs

11.84 Parliamentarians and Canadians need relevant information on illicit drugs. For activities that involve several federal departments, and in this case provincial/territorial, and municipal governments, comprehensive public reporting is needed. This type of reporting eliminates the need to search individual performance reports and is the only way that parliamentarians and the public can clearly understand Canada's response to the illicit drug problem.

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Exhibit 11.8 Assessment of departmental performance reports, 1999–2000

Department or agency	Resources	Objectives	Results
Royal Canadian Mounted Police (Federal Policing Services)	◓	○	◓
Canada Customs and Revenue Agency	○	○	●
Department of Justice	○	○	○
Correctional Service Canada	○	◓	◓
Health Canada (consolidated)	○	○	○

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11.85 Comprehensive government-wide reporting should describe the environment in which the drug strategy operates and provide aggregated or broad information on expectations, concrete targets, results, and strategies for improving success in the future. In many respects, this is the same information that each department should routinely produce to manage its own activities.

11.86 Although the federal government provides leadership and co-ordination for dealing with the illicit drug problem, it has not produced any comprehensive reports that demonstrate how well Canada is managing the problem. It would be logical for Health Canada, as the lead department, to report government-wide results of Canada's efforts to reduce the demand for and the supply of illicit drugs.

11.87 Two Canadian examples of comprehensive reporting are reports on family violence and HIV/AIDS. Examples of comprehensive reporting on the drug problem are found in some other countries, such as the United Kingdom and the United States. In both countries, the agencies involved report annually to their legislatures. This type of reporting would give Canada's parliamentarians a readily accessible overview of the current drug situation in Canada, the strategy for combatting the problem, and some indication of success.

Leadership and co-ordination

Good leadership and co-ordination are essential

11.88 For the last 15 years, Canada's Drug Strategy has emphasized the need for a balanced approach. This balance means striking the appropriate level of effort between reducing the demand for illicit drugs and their supply. The various activities in this approach are carried out by hundreds of different stakeholders in municipal, provincial/territorial, and federal governments and in non-government organizations. Achieving a balance requires a clear understanding of the efforts of all stakeholders across Canada. Currently, the federal government does not know the status of the overall national effort.

11.89 One issue the government needs to consider is the national profile of the illicit drug problem. Some other countries have given it more prominence. In the United Kingdom, for example, the Prime Minister has appointed a champion to lead this effort. The President of the United States has also nominated a champion. In Australia, there is a ministerial committee comprising ministers from the federal and state levels.

11.90 Leadership and co-ordination are best facilitated by continuing government commitment. Over the 15 years of Canada's Drug Strategy, funding has been intermittent. In 1998 Health Canada requested but did not receive funds for activities such as prevention, treatment and rehabilitation, knowledge development, and enforcement. We understand that the renewal of Canada's Drug Strategy is under way. Lack of funding over the past five years has directly affected Health Canada's ability to co-ordinate and implement the strategy.

11.91 If Canada is to address the complicated issue of illicit drugs effectively, it needs strong leadership and co-ordination to do the following:

- implement an effective co-ordinating structure;
- establish common objectives and a common strategy;
- respond quickly to emerging issues;
- ensure that collective performance expectations are stated clearly;
- ensure that performance is measured and reported;
- make performance information more accessible to improve Canada's efforts at reducing the use of illicit drugs;
- report comprehensive performance information; and
- recommend changes that cross departmental lines.

11.92 **Health Canada's role.** Since 1987 Health Canada has had the role of leading and co-ordinating Canada's efforts against illicit drugs. In this role, it has chaired the two key interdepartmental committees on illicit drugs. Co-ordination is provided by the Office of Canada's Drug Strategy, a small group in Health Canada. In 1999–2000, its expenditures on co-ordination, including salaries for its staff, were under $1 million.

11.93 For Health Canada, the illicit drug problem is secondary to a great many other health issues, such as access to health care, the effects of tobacco and alcohol use, and cancer. However, the problem is much more than simply a health issue; as noted, most of the federal government's related activities are in enforcement.

11.94 There are limits on Health Canada's authority as co-ordinator. For example, the Department cannot reallocate resources from budgets of other departments; it cannot directly manage the estimated $432 million to $454 million in federal resources; and it does not speak on behalf of the different federal departments and agencies involved in reducing the demand for or the supply of illicit drugs. Instead, Health Canada's co-ordinating role is limited to providing secretariat services to various co-ordinating committees and to co-ordinating activities such as Treasury Board submissions and memorandums to Cabinet.

11.95 **Integration of all efforts is crucial.** Effective leadership and co-ordination are essential not only at the federal level but also at the municipal and provincial/territorial levels. It is crucial that the activities of all the different players be well-integrated. Although the issue of illicit drugs may not be a high priority for an individual organization, it has a significant impact on Canada. The federal government can integrate activities and achieve a proper balance among them only if it is committed and provides strong leadership and co-ordination.

Conclusion and Recommendations

11.96 Illicit drugs continue to have a significant negative impact on Canada. To combat the problem successfully, Canada needs good information, reporting, and leadership.

11.97 Key information on the drug environment, such as frequency and prevalence of drug use, and its impact on society, is either not available or not up-to-date. Of particular concern is the almost complete absence of basic management information on spending of resources, on expectations, and on results of an activity that accounts for almost $500 million each year. Without accurate and relevant information in these areas, it is impossible either to assess the results achieved with the money spent or to measure the progress of the activity.

11.98 There is also no comprehensive public reporting on illicit drugs, even though 11 federal government departments and agencies and provincial/territorial and municipal governments are involved in related activities. The sheer number and diversity of players working on two fronts—reducing demand and reducing supply—make it crucial that their activities be integrated and reported on a comprehensive basis. The lack of integration and relevant information on performance means that neither Parliament nor Canadians know how well the government is addressing the problem of illicit drugs. Until the government provides comprehensive public reporting at the national level, it will be impossible to measure the net effectiveness of Canada's Drug Strategy.

11.99 Some other countries clearly emphasize the need for strong leadership and co-ordination to deal effectively with the illicit drug problem. Canada has not given it the same emphasis. To make progress, the federal government needs to give the illicit drug problem a higher profile, provide continuity in funding, and offer higher commitment and stronger leadership. It must have a leadership structure that is responsive to emerging concerns.

11.100 **Recommendation.** The government should improve the sparse and outdated information on the nature, extent, and consequences of the illicit drug problem in Canada; develop performance information that includes costs, expectations, and results; and report on a comprehensive basis to Parliament and Canadians on how well Canada is dealing with illicit drugs.

11.101 **Recommendation.** The government should ensure that Canada's Drug Strategy receives the profile and dedicated resources necessary to deal with the illicit drug problem in Canada.

11.102 **Recommendation.** The government should review the current mechanisms for leadership and co-ordination within the federal government as well as mechanisms for co-ordination with provincial/territorial and municipal governments in addressing the problem of illicit drugs.

Government's response. Canada's Drug Strategy reflects a balance between the objectives of reducing the demand for and the supply of drugs. It is a strategy based on four important pillars: prevention, enforcement and control, treatment and rehabilitation, and harm reduction. The strategy is managed as a partnership among 11 federal departments and agencies who work together and includes provincial/territorial partners, non-governmental organizations, municipalities, service providers, and other front-line organizations. While substance abuse is a health and social problem, there are links to drug trafficking, money laundering, organized crime, and terrorism. Because of the primary health concern, the lead for Canada's Drug Strategy resides with Health Canada.

The government will consider, within the existing co-ordination framework, reviewing and enhancing its management of this horizontal issue to develop a more integrated drug strategy that could include increased capacity for co-ordination, evaluation, reporting, and consideration of other government priorities and initiatives. The Auditor General's recommendations and the recommendations forthcoming from the Special Committee on Illegal Drugs and the Special Committee on Non-Medical Use of Drugs will guide government efforts in the further elaboration of Canada's Drug Strategy.

About the Audit

Objectives

The objectives of the audit were to determine whether the government has the following in place:

- adequate information on the extent of the illicit drug problem as well as the information needed to manage its activities;
- comprehensive public reporting on objectives and results; and
- clear leadership and co-ordination.

Scope

The audit focussed on the federal government's efforts to address illicit drugs in the context of Canada's Drug Strategy. In particular, it focussed on high-level issues of leadership and co-ordination, information, objectives, performance measurement, and reporting to Parliament.

The audit included many of the key players in Canada's Drug Strategy: Health Canada, Solicitor General Canada, the Royal Canadian Mounted Police, Correctional Service Canada, the Department of Foreign Affairs and International Trade, the Canada Customs and Revenue Agency, and the Department of Justice.

Criteria

We expected to find the following:

- clear information and reporting by all federal departments and agencies;
- current and relevant information on the extent of illicit drug use;
- management information such as expenditures, objectives, and results;
- some comprehensive public reporting on how well Canada is handling the illicit drug problem; and
- strong leadership and co-ordination.

Audit team

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Report of the Auditor General of Canada to the House of Commons—2001

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Report of the
Auditor General of Canada
to the House of Commons

Other Observations and Appendices

Chapter 12
Follow-Up of Recommendations in Previous Reports

Chapter 13
Other Audit Observations

Appendices

The 2001 Report of the Auditor General of Canada comprises 13 chapters, Matters of Special Importance—2001, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

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Chapter

12

Follow-up of Recommendations in Previous Reports

The follow-up work was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Follow-up of Recommendations in Previous Reports

Main Points

12.1 Progress by the government in taking corrective action is uneven. In the departments' and agencies' responses to our audits, they committed to taking action and correcting deficiencies. In our follow-up work, we found many cases where they have made reasonable progress. But in other cases, progress is more limited. We encourage departments and agencies to complete the action necessary to resolve the issues raised.

12.2 Citizenship and Immigration Canada and the Immigration and Refugee Board are actively taking steps to address the issues raised in our 1997 audit. However, progress related to receiving refugee claims and handling failed claims cannot be fully assessed until the proposed legislation is passed and the ensuing regulations issued. Citizenship and Immigration Canada could not provide information on removals of failed refugee claimants that would indicate whether its processes were more effective.

12.3 National Defence is making slow progress addressing concerns that we raised in our 1999 audits of the management of hazardous materials and the risk of fraud and abuse by employees. In the case of hazardous materials management, the Department has not yet completed its national-level environmental management system. Therefore, little improvement in compliance can be expected before 2004 when this project is complete. Similarly, the Department has not yet fully implemented the Defence Ethics Program—the cornerstone of its efforts to promote ethical conduct and eliminate fraud and abuse.

12.4 In our follow-up of our 1998 audit of comprehensive land claims, we found that fundamental issues related to the current treaty negotiation process remain. These include the difficulty of achieving certainty and the length of time to reach agreements. Progress in these areas depends on the political will, co-operation, and good faith of all parties concerned. Although Indian and Northern Affairs Canada has taken action to address our recommendations, progress in evaluating the impacts of settlements and in capturing and reporting the complete costs of settling and implementing land claims is slow.

12.5 The government has not addressed our concerns about management oversight that we raised in our 1998 and 1999 audits on contracting for professional services using sole-source contracts. However, it has issued a new policy on advance contract award notices and has acted on our recommendations related to training. The Treasury Board Secretariat continues to reject our recommendation that departments with significant levels of sole sourcing be required to conduct annual assessments of their compliance with the regulations.

12.6 The Canada Customs and Revenue Agency has addressed most of the recommendations from our 1999 audit of the Underground Economy Initiative and continues to work on three other recommendations. These include providing additional performance indicators on the impact the Initiative has had on reducing the underground economy, improving selection of audit files, and reporting the additional tax resulting from underground economy audits.

12.7 The Department of Foreign Affairs and International Trade acted on all the recommendations raised in our 1999 audit of the delivery of capital projects in four missions. It has improved its planning capacity for capital projects and strengthened its guidelines for the planning of projects. The Department has also completed a comprehensive report on steps being taken to improve the management of property in the Department.

12.8 The Patented Medicine Prices Review Board has made good progress in addressing our recommendations from our 1998 audit, in particular for those areas most directly within its control. Several of the recommendations involved reviewing the *Patent Act* or regulations and consulting with Industry Canada and Health Canada. The Board has taken action on most of those recommendations as well.

Introduction

12.9 We make recommendations in each of our audits to focus attention on correcting current or future problems and to improve the management of government. We encourage management of the entities that we audit to respond to us in writing, stating whether they agree with our recommendations and how they plan to take corrective action. In turn, we publish their responses in our report, so that Parliament and the public can judge their commitment. Approximately two years after an audit, we return to determine what corrective action the entity has taken. This work forms the basis of our follow-up report.

12.10 It is important to clarify what a follow-up is, and is not. Apart from a few unique situations, it is not a second audit of the same issues. Rather it is a report on what management tells us, or can demonstrate to us, about the progress it has made toward addressing our recommendations since our initial audit. We do not exhaustively seek or examine additional evidence to support or refute what management has told us, but we do review its claims for reasonableness and report to Parliament accordingly.

12.11 This chapter contains our follow-up report on 21 chapters reported between 1995 and 1999. We also discuss our follow-up work on other chapters (Exhibit 12.1).

12.12 Many entities made satisfactory progress in taking corrective action. However, there are also many instances where delays resulted in the government not achieving as much as it could. Examples where progress is slow include the National Defence's management of hazardous materials and Indian and Northern Affairs Canada's evaluation of the impacts of settlements and reporting of the full costs of comprehensive land claims. For some long-standing issues, such as the settlement of land claims, progress is slow because it depends on the political will, co-operation, and good faith of other involved parties.

12.13 This will be the last year that we publish a chapter of follow-up reports in this format. We are currently revising what we follow up and how we report our findings. We will continue to track departmental progress in taking corrective action toward our recommendations but will focus more of our attention on reporting significant issues to Parliament.

Exhibit 12.1 Follow-up work reported in other chapters

Chapter	Title	Responsible auditor	Comment
1997 Report			
10	Natural Resources Canada—Energy Efficiency	Wayne Cluskey	Included in Chapter 6 of the 2001 Report of the Commissioner of the Environment and Sustainable Development.
1998 Report			
27	Department of Canadian Heritage—Grants and Contributions Under the Multiculturalism Program	Peter Simeoni	Originally included in Chapter 33 of our 2000 Report. A further follow-up is included in Chapter 5 of this Report.
1999 Report			
19	Industry Portfolio—Investing in Innovation	Peter Simeoni	Included in Chapter 5 of this Report.
21	Financial Information Strategy: Departmental Readiness	Eric Anttila	Included in Chapter 1 of this Report.
2000 Report			
11	Human Resources Development Canada—Grants and Contributions	Theresa Duk Henno Moenting	Included in Chapter 5 of this Report.

Federal Transportation Subsidies—The *Western Grain Transportation Act* Program (1995, Chapter 6)

Assistant Auditor General: Hugh McRoberts
Director: Diamond Lalani

Background

12.14 In 1983 the *Western Grain Transportation* Act was enacted to facilitate the transportation, shipping, and handling of Western grain to export markets. The *Western Grain Transportation* Act Program was subsequently developed as one of the major federal direct subsidy programs for surface freight operated by the federal government. The Program assigned specific roles to the Grain Transportation Agency and the National Transportation Agency. The Act and the Program worked together with other legislation, government agencies, producers, railways, and private interests to constitute Canada's grain handling and transportation system.

12.15 In 1995 we audited the *Western Grain Transportation* Act Program and reported our observations and recommendations in our May 1995 Report, Chapter 6. This year we conducted a follow-up to determine the progress made by the Department since our last audit.

Focus of the follow-up

12.16 The scope of our review was restricted to identifying and analyzing the changes that have occurred since the end of our 1995 audit. Our work involved reviewing documents and discussing them with management. While we assessed the documents for reasonableness and consistency, we did not seek independent, corroborative evidence to verify the information in them.

Conclusion

12.17 Overall, the Department has made satisfactory progress in dealing with our recommendations related to the grain handling and transportation system. Since our 1995 audit, the Department has taken a number of initiatives that have led to major reforms to the system; these include a comprehensive review of the grain handling and transportation system and consultations with stakeholders.

12.18 The Department indicated that it has developed a program design to monitor the grain handling and transportation system and the impacts of the reforms on stakeholders, and it has engaged an independent third party monitor to implement the design.

Observations

Changes in the grain handling and transportation system since our 1995 audit

12.19 Since 1995, the *Western Grain Transportation Act* has been repealed and grain traffic is now covered by the *Canada Transportation* Act. The role of the National Transportation Agency was limited to the calculation of annual adjustments to the maximum rate; the Grain Transportation Agency became part of Transport Canada and was renamed the Western Grain Transportation Office for a one-year transition period before the industry assumed responsibility for allocating grain cars.

12.20 On 10 May 2000, the Minister of Transport, together with the Minister of Agriculture and Agri-Food and the Minister responsible for the Canadian Wheat Board, announced the government's intention to introduce measures to increase efficiency and cut costs in Canada's grain handling and transportation system. He stated that the reforms to be implemented by 1 August 2000 included the following:

- the establishment of a revenue cap that provides for an annual estimated $178 million reduction in railway revenues, which represents an estimated 18 percent reduction in grain freight rates from 2000–01 levels;
- the phase-in of Canadian Wheat Board tendering for logistical services for grain shipments through the ports of Vancouver, Prince Rupert, Thunder Bay, and Churchill, from at least 25 percent of their volume in 2000–01 to a minimum of 50 percent in 2002–03; and
- amendments to the *Canada Transportation Act* to facilitate the transfer of branch lines to community-based short lines and to simplify the Final Offer Arbitration process.

12.21 Bill C-34 (an Act to amend the *Canada Transportation Act*) that became effective 26 July 2000, with some provisions becoming effective 1 August 2000, has brought into effect changes to Canada's grain handling and transportation system, with an objective of more flexibility in pricing for grain movements.

12.22 The Minister also announced that an independent third party will provide a transparent and continuous monitoring program to assess the overall efficiency of the grain handling and transportation system, including the impact of changes on farmers, the Canadian Wheat Board, railways, grain companies, shippers, and ports.

Demand peaking

12.23 In 1995 we recommended that the Department study the costs and benefits associated with the way the Western Canadian grain transportation system responded to demand peaking.

12.24 The Department has not done any cost-benefit analysis in this area. However, it believes that the major reforms to the grain handling and transportation system will encourage a more commercial system, including more flexible policies for setting grain freight rates and a more commercial approach to car allocation. The new policy environment provides industry participants with a more market-based signal and alternatives to address demand peaking.

Car cycle times

12.25 In 1995 we recommended that the Department measure and report on grain hopper car cycle times on a timely basis.

12.26 In 1999 the Department implemented amendments to the Carriers and Transportation Undertakings Information Regulations that provide access to more information related to grain handling and transportation, including information on railway car cycle times. The Department indicated that it has received car cycle information related to the 1999–2000 crop year, which it is currently reviewing. The Department has also developed a program design that is intended to monitor the grain handling and transportation system and that includes elements pertaining to car cycle times.

Reviews of the program

12.27 In 1995 we recommended that the Department, along with the National Transportation Agency, take steps to ensure that the government has the information, expertise, and resources necessary to carry out any work it will be responsible for under the 1998 and 1999 reviews of the *Western Grain Transportation Act* Program announced in the 1995 Budget.

12.28 The Department indicated that the staff from the Canadian Transportation Agency and the Department provided information and assistance to the reviews that were conducted.

Revenue Canada—Child Tax Benefit and Goods and Services Tax Credit Programs (1996, Chapter 19)

Assistant Auditor General: Shahid Minto
Principal: Ronnie Campbell

Background

12.29 In the five years since our audit, changes have been made to both the Child Tax Benefit (CTB) and the Goods and Services Tax Credit (GST Credit) programs. The CTB was introduced in 1993 as a tax-free monthly payment to help families with low to moderate incomes. It was folded into an enriched program called the Canada Child Tax Benefit (CCTB) in July 1998. The CCTB program is the vehicle used to provide the federal portion of a joint federal, provincial, and territorial government initiative called the National Child Benefit. Like the former CTB, the CCTB is based on the number of children in the family and the level of family income.

12.30 The Goods and Services Tax Credit was introduced in 1990 to help families and individuals with low to moderate incomes offset all or part of the GST they pay. In the three provinces that have since combined their provincial sales taxes with the GST to create a harmonized sales tax, the GST Credit continues to apply. Both the CCTB and the GST Credit are administered by the Benefit Programs Directorate of the Canada Customs and Revenue Agency (CCRA).

12.31 In our 1996 audit, we noted that Revenue Canada (now CCRA) had not tested the level of awareness of the CTB and GST Credit programs and did not have profiles of the specific information needs of participants. As well, it had not measured the take-up rates to ensure that the programs were reaching all those entitled to receive them. The audit also found inconsistency in primary caregiver decisions and a lack of controls to protect against fraud and abuse and to ensure data accuracy. There was also a lack of service standards and monitoring of overpayments and no formal evaluation of the CTB and GST Credit by the Department of Finance. These observations still apply, despite the changes in these programs. In response to our audit, Revenue Canada prepared a five-point action plan that was appended to our 1996 chapter.

Focus of the follow-up

12.32 Our follow-up work involved reviewing status reports provided by CCRA and the Department of Finance on their progress in implementing our 1996 recommendations. Our observations are also based on a review of other documents provided to us and interviews held with officials of the Benefit Programs Directorate.

Conclusion

12.33 Given that it has been five years since our audit, we expected that the CCRA would have completed its action plan to address our concerns and recommendations. While the Benefit Programs Directorate has carried out a number of activities to address our observations and recommendations, several important issues remain to be addressed. These include developing participant profiles, obtaining complete and accurate knowledge about the CCTB and GST Credit take-up rates, strengthening the monitoring of overpayments, and quantifying the extent of inaccuracy of the database. As well, the Department of Finance has yet to evaluate whether the programs are meeting their intended objectives.

Observations

Activities under way to increase awareness of programs, but participant profiles not yet developed

12.34 In 1996 we observed that Revenue Canada had not tested the national level of awareness of the programs and did not have profiles of participants in the programs and their specific information needs. In addition, we found that the Department could do more to inform families of their legal obligation to report changes that could affect benefit payments, such as changes in address, marital status, and number of eligible children.

12.35 The Directorate undertook a number of activities in response to our audit. It monitored inquiries from the public to determine the nature of CCTB calls, and it conducted a client satisfaction survey of the CCTB application process. It also conducted focus groups on the wording of CCTB and GST Credit notices, and it revised client contact letters to remind recipients to report changes affecting benefit payments.

12.36 As well, the Directorate developed communication strategies for the CCTB and the GST Credit. Many of the activities in the strategies are under way, such as sending targeted mail-outs to clients to remind them of their obligations and providing program information to new immigrants. However, as part of these strategies, the Directorate still needs to develop profiles of existing and potential clients and their specific information needs.

12.37 In 2000 the CCRA conducted a national telephone survey to provide baseline information on various programs. The survey showed that 57 percent of respondents were aware that the CCRA manages the CCTB program, and 69 percent were aware that it manages the GST Credit program. However, management has indicated that the results were not conclusive because the survey questions did not separate awareness of the programs from the CCRA's role in managing them.

12.38 Although many actions have been taken, the national level of awareness of these programs is still unknown and profiles of potential and current participants have not yet been developed.

Complete and accurate information needed for take-up rates

12.39 The take-up rate is a statistic that represents the proportion of all individuals for whom the benefits are intended who actually receive them. In 1996 we recommended that the Department periodically measure and report on the take-up rate for both the CTB and the GST Credit programs.

12.40 In 1997 the Benefits Program Directorate measured the CTB take-up rate using 1995 and 1996 birth data made available by three provinces. The results indicated that approximately 95 percent of entitled children were enrolled within a year of their birth. However, these results could not be projected to yield national results due to a lack of information from other provinces and a lack of data on immigrants, emigrants, and deceased children.

12.41 In 1998 the Directorate conducted a study to determine the CTB take-up rate for a sample of children who received landed immigrant status in 1996. However, the integrity of the results was compromised because it was not possible to confirm that the children were in Canada and therefore eligible for the CTB.

12.42 Also in 1998, the Directorate approached the Privacy Commissioner for permission to obtain provincial and territorial information on the births and deaths of children. This information would enable it to determine the CCTB take-up rate on an ongoing basis, rather than negotiating periodically with the provinces for information. However, the Privacy Commissioner deemed that the release of this information would be an unwarranted invasion of privacy.

12.43 The Directorate has established a recent take-up rate for the GST Credit. Two studies, involving potential recipients from the 1995 and 1999 tax return years, showed that 98.5 percent and 98.2 percent of entitled taxpayers respectively claimed the credit. However, it is not clear that they claimed it for the correct number of children. The most recent study revealed a substantial discrepancy in the number of children recorded for the GST Credit compared with the CCTB.

12.44 In our view, complete and accurate information on take-up rates is still needed. The Directorate plans to explore other avenues to monitor take-up rates in the future.

Steps taken to ensure consistency in primary caregiver decisions

12.45 Where two or more applicants claim they are entitled to child tax benefits for the same child, the CCRA must determine who the primary caregiver is, since only that person is eligible for the CCTB benefit. In 1996 we noted that there was little quality control in this area. We recommended that uniform policies and monitoring practices for review of such decisions be established.

12.46 In response, the Directorate revised the CCTB application form to include custody information, improved the standard questionnaires used to verify the child's primary caregiver, and updated the operating manual to provide better guidance to field officers.

12.47 Despite these steps, a 1999 internal audit reported that staff were concerned about the effectiveness and efficiency of the revised questionnaire and procedures. As a consequence, the Directorate made additional changes and developed a training package to ensure consistency in the application of the procedures.

12.48 Management has informed us that the monitoring of primary caregiver decisions occurs as part of a broader review of application processing that is conducted in field offices, although specific results relating to these decisions are not available.

Overall accuracy of database not known

12.49 In 1996 our analysis suggested that there were more children on the tax benefit roll than the entitled child population overall, including some deceased children. In addition, we found that benefits were being processed when there was incomplete or inconsistent information, particularly relating to marital status. We recommended that Revenue Canada institute an appropriate control environment and enforcement regime to protect against fraud and abuse and to ensure data integrity.

12.50 In response to our concerns, the Directorate conducted two studies in 1997. One study concluded that the enrolment of non-existent children in the CTB program was not a problem to the extent that additional action was required. The second study found that 30 percent of deaths of children enrolled in the CTB program in Alberta and British Columbia go unreported and, in some of these cases, CTB payments could continue until the child reached 18 years of age. The Directorate then increased its efforts to educate clients about their obligation to inform Revenue Canada about deceased children. There has not been a follow-up study to determine the impact of these efforts.

12.51 The Validation and Controls Section was created in 1997 to deal with incomplete and inconsistent information. Revenue Canada developed a three-year quality assurance and compliance strategy and created a comprehensive database to target files for review based on the probability of mispayment and the dollars at risk.

12.52 The quality assurance and compliance strategy included plans to separately select statistically valid samples of files to determine compliance levels as well as causes and amounts of overpayments or underpayments. A random sample of files was chosen for 2000. Files that had recently been worked on were screened out. Preliminary findings for the remainder show that 68.4 percent required no adjustment, 7.6 percent were adjusted for marital status or child entitlement, 6.7 percent are still in process, and 17.3 percent could not be verified due to lack of response from the recipient.

12.53 In 2000–01, the Validation and Controls Section adjusted 27.8 percent of the targeted files it reviewed. For some adjustments related to an internal computer problem in recognizing marital status, management estimated that CTB/CCTB overpayments could have been as high as $1.5 million each year since 1993, with additional provincial and GST Credit overpayments. Many more files in the inventory have yet to be adjusted.

12.54 The Validation and Controls Section has not quantified the total value of overpayments, underpayments, and potential tax loss that it has detected as a result of its work. Nor has it projected its random sample findings to provide an overall assessment of the degree of inaccuracy in the database. Management is considering an online project management system to provide this type of information in the future.

Trends in overpayment of benefits uncertain

12.55 In 1996 we noted that the Department had only begun to analyze overpayments in the CTB program, and no information was available to track GST Credit overpayments. We recommended that it develop improved systems for the control and collection of known overpayments.

12.56 In 1996 management indicated that CTB overpayments were $69 million. However, in March 2000 the CCRA realized that a programming error had existed since 1993, and the receivables could have been $122 million. Management also informed us that at April 2001, CCTB receivables were $116 million. The magnitude of the undetected error and the delay in detecting it raises continuing concerns about the extent of monitoring of overpayments.

12.57 The Directorate has done no analysis of GST Credit overpayments, although they were estimated to be $20 million in 1996. Until recently, GST Credit overpayments were transferred to the individual accounting system, where they could not be separately identified. As of July 2001, overpayments are separately tracked.

12.58 Despite the above-noted weaknesses, the Directorate has taken some positive steps to reduce overpayments. These include reducing the number of contingency payments that are made while waiting for tax returns to be received and processed, automatically offsetting CCTB overpayments by tax refunds, and automatically transferring debts to the collections system, resulting in more proactive collections action.

Published service standard for application processing is now in place

12.59 In 1996 we reported backlogs in the processing of CTB applications and poor access to telephone lines. Program officials informed us that applicants could expect to wait two to three months from the time their application was received by the CCRA until they received a cheque. In addition, 90 percent of callers using the benefit phone lines received a busy signal. We recommended establishing standards of service for the benefit programs and reporting performance in achieving those standards.

12.60 Since our report, the Agency has published a service standard for application processing time. It states that a CCTB payment, or explanation as to why no payment is forthcoming, will be issued before the end of the second month following the month of receipt of a completed application. This standard was met 90 percent of the time in 1999 and 98 percent of the time in 2000. The Directorate has informed us that additional service standards are being developed.

12.61 Access to phone lines has improved since 1996, with the introduction of messaging systems and call centres using interactive voice response systems. Callers now receive a busy signal only 62 percent of the time. Further improvements in accessibility are expected with the recent implementation of national traffic routing of CCTB and GST Credit calls.

Department of Finance has not formally evaluated CCTB and GST Credit programs

12.62 Although the Child Tax Benefit was put in place in 1993 and the GST Credit in 1990, we noted five years ago that neither program's performance had been evaluated against program objectives. When the CTB was replaced by the Canada Child Tax Benefit and the collaborative federal/provincial/territorial National Child Benefit initiative, the three partners made a commitment to monitor and evaluate the National Child Benefit on an ongoing basis.

12.63 Since then, National Child Benefit progress reports have been published for 1999 and 2000. These reports examined changes over time in a set of indicators, such as the number of children living in poverty in Canada and the number of families leaving welfare and earning employment income. However, they concluded that it is difficult to know the degree to which the changes are attributable to the National Child Benefit. This can be determined only by carrying out an extensive evaluation. Such an evaluation is now scheduled for completion in the spring of 2002. It will include an assessment of federal child benefits as well as provincial and territorial contributions.

12.64 The Department of Finance has not yet conducted a formal evaluation of the GST Credit program to ensure that it is meeting its intended objective.

Citizenship and Immigration Canada and Immigration and Refugee Board—The Processing of Refugee Claims (1997, Chapter 25)

Assistant Auditor General: Shahid Minto
Principal: John Hitchinson

Background

12.65 In our 1997 chapter, we concluded that a thorough review of the refugee determination process was needed. The process did not quickly grant Canada's protection to claimants who genuinely needed it, and it did not discourage those who did not need or deserve Canada's protection from claiming refugee status.

12.66 Since then, the government has introduced new legislation on immigration and refugee determination. The House of Commons passed Bill C-11, the *Immigration and Refugee Protection Act*, on 13 June 2001. At the time of our follow-up, the Senate was considering the Bill.

Focus of the follow-up

12.67 We assessed progress on the recommendations made in our 1997 chapter, specifically on the three key steps of the refugee determination process: receiving refugee claims, determining refugee status, and handling failed claims. Our observations are based on interviews with officials of Citizenship and Immigration Canada and the Immigration and Refugee Board, and a review of documents provided to us.

Conclusion

12.68 Progress related to receiving refugee claims and handling failed claims cannot be fully assessed until the proposed legislation is passed and the ensuing regulations have been issued. However, we note that both Citizenship and Immigration Canada and the Immigration and Refugee Board are actively taking steps to address the issues we raised.

12.69 The Immigration and Refugee Board has made satisfactory progress in addressing most recommendations related to refugee determination. However, Citizenship and Immigration Canada could not provide information on removals of failed refugee claimants from the country that would indicate whether its processes were more effective; the Department is still developing a National Case Management System that will help address this issue. Both organizations still need to improve the information they provide to Parliament.

Observations

Receiving refugee claims

12.70 In 1997 we recommended that Citizenship and Immigration Canada review the mechanisms used in applying the eligibility criteria set out in the *Immigration Act*. Under Bill C-11, the decision on eligibility must be made within three working days after the claim is received, or the claim is automatically referred to the Immigration and Refugee Board. The Department is working on a project to implement a new screening process.

Until the proposed legislation becomes effective and the project is completed, we cannot assess progress toward addressing the recommendation.

12.71 We also recommended that Citizenship and Immigration Canada and the Immigration and Refugee Board co-operate to establish a common strategy for ensuring that all information relevant to the processing of refugee status claims is collected in a timely fashion. In our view, both the Department and the Board have made satisfactory progress toward increasing their co-operation. The Administrative Framework Agreement between the Department and the Board has been followed by agreements on sharing of information and on co-ordination of priorities.

12.72 In 1997 we found that the majority of persons claiming refugee status at ports of entry in Canada arrived from a country other than one where they may be subject to persecution. We also found that the "safe third country" provision of the legislation to safeguard the system against an influx of claimants who did not need Canada's protection had never been implemented. The proposed legislation maintains that provision. Negotiations with the United States to apply the provision were suspended in December 1997. Since then, no formal negotiations have taken place.

Selection of Board members

12.73 We recommended that the government ensure that the selection process for Board members provide greater certainty that appointments or reappointments to the Immigration and Refugee Board are based on the qualifications needed to respond to the complexity and the importance of the task. In 1997 the Minister requested that the advisory committee created in 1995 to assist in the selection of Board members recommend mechanisms to be put in place to improve the process.

12.74 The Ministerial Advisory Committee developed screening tools to evaluate the candidates according to established criteria. The Committee had five meetings in 2000 to recommend candidates to the Minister and two meetings by the end of June 2001. Between January 2000 and June 2001, the Board received more than 300 applications for Board member positions. The Committee recommended 115 candidates to the Minister, and 33 were appointed to the Board.

12.75 In 1999 the Immigration and Refugee Board implemented a new performance appraisal program for Board members. One of the purposes of this program is to provide a basis for the members' continuing tenure with the Board. Recommendations for renewals are no longer the responsibility of the Ministerial Advisory Committee but that of the Performance Review Committee of the Board. The Review Committee contributes to the reappointment process by overseeing the appraisal process that provides a report to the Minister at the end of a member's term as advice on reappointment.

12.76 We noted that the turnover rate for Board members has decreased since 1997, from 20.9 percent to 9.4 percent in 2000. New appointments are generally made for two years, and the Board seeks the reappointment of

members for five years. In April 2001, there were 196 Board members and 19 vacant positions. This was an improvement from 1997 when 28 positions were vacant.

12.77 As shown in Exhibit 12.2, the number of refugee claims received by Citizenship and Immigration Canada has increased in recent years. Management at the Department also confirmed that trend for the current fiscal year. The inventory of cases at the Immigration and Refugee Board is also increasing. We remain concerned that the Board may not have the necessary complement of staff to deal with an increasing inventory.

Informed decision making

12.78 In 1997 we noted that the information available to Board members did not always foster informed and equitable decisions. The Department and the Board have taken a number of measures to address this issue. In 1998–99, the Immigration and Refugee Board implemented the National Learning Framework and customized training programs for both new and experienced Board members. Since implementation of the framework, 24 new members and 22 more experienced members have been trained. The Board organized issue analysis sessions in 2000 and 2001 to enhance the quality of decisions by promoting greater consistency in the treatment of similar cases. More sessions are planned for the coming year.

12.79 The Board created national geographic networks based on the six major world regions from which refugee claims are received. These networks are intended to facilitate the exchange of information and viewpoints among members, refugee claim officers, and researchers. Country-specific analyses of differences in acceptance rates of claimants from the same country are also produced. The Board has undertaken an inter-regional exchange of members to deal with high variances in acceptance rates.

12.80 Additional resources have been obtained to create a team responsible for quality assurance. Although the need for consistency must be reconciled with adjudicative independence, the Department and the Board can work to identify areas where decision makers can adopt a consistent approach without impinging upon the independence of individual decision makers.

Exhibit 12.2 Statistical data on claims

	1996–97	1997–98	1998–99	1999–2000	2000–01
Claims received by Citizenship and Immigration Canada	23,999	24,808	26,245	32,232	40,326
Claims referred to the Immigration and Refugee Board	23,546	23,444	25,198	31,011	35,111
Claims finalized at the Board	23,251	25,099	30,034	27,771	29,893
Inventory of cases at the Board	29,319	27,664	22,828	26,068	31,286

Source: Citizenship and Immigration Canada and Immigration and Refugee Board members for five years. In April 2001, there were 196 Board members and 19 vacant positions. This was an improvement from 1997 when 28 positions were vacant.

12.77 As shown in Exhibit 12.2, the number of refugee claims received by Citizenship and Immigration Canada has increased in recent years. Management at the Department also confirmed that trend for the current fiscal year. The inventory of cases at the Immigration and Refugee Board is also increasing. We remain concerned that the Board may not have the necessary complement of staff to deal with an increasing inventory.

Informed decision making

12.78 In 1997 we noted that the information available to Board members did not always foster informed and equitable decisions. The Department and the Board have taken a number of measures to address this issue. In 1998–99, the Immigration and Refugee Board implemented the National Learning Framework and customized training programs for both new and experienced Board members. Since implementation of the framework, 24 new members and 22 more experienced members have been trained. The Board organized issue analysis sessions in 2000 and 2001 to enhance the quality of decisions by promoting greater consistency in the treatment of similar cases. More sessions are planned for the coming year.

12.79 The Board created national geographic networks based on the six major world regions from which refugee claims are received. These networks are intended to facilitate the exchange of information and viewpoints among members, refugee claim officers, and researchers. Country-specific analyses of differences in acceptance rates of claimants from the same country are also produced. The Board has undertaken an inter-regional exchange of members to deal with high variances in acceptance rates.

12.80 Additional resources have been obtained to create a team responsible for quality assurance. Although the need for consistency must be reconciled with adjudicative independence, the Department and the Board can work to identify areas where decision makers can adopt a consistent approach without impinging upon the independence of individual decision makers.

Exhibit 12.2 Statistical data on claims

Claims received by Citizenship and Immigration Canada	23,999	24,808	26,245	32,232	40,326
Claims referred to the Immigration and Refugee Board	23,546	23,444	25,198	31,011	35,111
Claims finalized at the Board	23,251	25,099	30,034	27,771	29,893
Inventory of cases at the Board	29,319	27,684	22,828	26,068	31,286

Source: Citizenship and Immigration Canada and Immigration and Refugee Board

Case processing

12.81 In 1997 we also noted that there were no clear directives governing the order of priority for processing cases and that each region set its own priorities. Personal information forms were received late, and postponements and adjournments were a major cause of Board delays. Since then, the Board has introduced a number of initiatives to improve its case management. A priorities co-ordination agreement was signed with Citizenship and Immigration Canada. Postponements and adjournments have been reduced by 41 percent since 1997–98. In March 2001, Personal Information Forms were received 37 days after the claim, compared with 47 days in 1997. Overall, the average processing time was reduced from 13 months in 1996–97 to 9.6 months in 2000–01. However, the continuing increase in the number of claims may result in longer processing times in the coming years. In addition, the Board is developing a case management system and expects to implement it in the spring of 2002.

Organizational climate

12.82 In 1997 we observed that most Board members and refugee claim officers described the organizational climate as negative or variable. Since the audit, the Immigration and Refugee Board has promulgated a vision, mission, and values statement in the organization. The National Learning Framework integrates learning for Board members and refugee claims officers. Teamwork is promoted throughout the organization, and this approach is particularly reflected in the national geographic networks.

Handling failed refugee claims

12.83 We recommended that Citizenship and Immigration Canada ensure that the risk-of-return review be within the scope of the objectives set for the Post-Determination Refugee Class in Canada, and that the review be carried out in an efficient and timely manner. A new process is being developed as a result of Bill C-11. Therefore, we could not assess progress on this recommendation.

12.84 We noted that more rigour was needed in evaluating applications for permanent residence on humanitarian and compassionate grounds. In December 1999, Citizenship and Immigration Canada issued a guideline on the handling of humanitarian and compassionate cases, and it provided training to staff. A coding system was implemented to track cases.

12.85 In 1997 we noted that the Department was experiencing a great deal of difficulty carrying out removals of failed refugee claimants. The Department continues to work on a co-ordinated approach with other government departments and agencies to improve co-operation from countries in issuing travel documents and accepting the return of their citizens. To date, the Department has negotiated bilateral removal arrangements with eight countries. However, factors we observed in 1997 that made it difficult to carry out removals quickly are still present.

12.86 We also noted in 1997 that the Department had insufficient information to manage removals adequately. The National Case Management System, a centralized database that provides management information and case-tracking support for enforcement activities, is currently operational in the Atlantic, Montreal, Toronto, and Vancouver offices. However, the system is not yet available to all offices across Canada. Consequently, the Department still lacks information that would help it determine whether its removal processes have become more effective.

Information to Parliament

12.87 In 1997 Citizenship and Immigration Canada and the Immigration and Refugee Board submitted Estimates to Parliament that did not provide complete and relevant information on the processing of refugee claims. Our review of the Department's 1999–2000 *Performance Report* showed that the Department still needed to put more emphasis on outcomes of activities related to the determination of refugee status. The Board's most recent report, for 1999–2000, showed that the Board needed to account more specifically for its achievements in enhancing the quality of decisions and promoting greater consistency in the handling of similar claims.

Expenditure and Work Force Reductions in the Public Service and in Selected Departments (1998, Chapters 1 and 2)

Assistant Auditor General: Maria Barrados
Principal: Kathryn Elliott

Background

12.88 In 1998 we published two chapters on expenditure and workforce reductions in the federal public service. These chapters reported the results of our audit of the departure incentive programs approved by the government. In Chapter 1 we examined the role of central agencies in applying the reductions across the federal government. Chapter 2 dealt with the ways that certain departments had carried out the reductions.

12.89 **Expenditure reduction.** Our 1998 audit examined the extent to which announced targets for expenditure and workforce reductions have been or are likely to be achieved. We concluded in Chapter 1 that the government was likely to meet the expenditure reduction targets of Program Review.

12.90 **Savings.** We examined the extent to which the costs of workforce reduction and initiatives had resulted in savings. In Chapter 1 we concluded that it was not possible to measure the precise extent to which incentives contributed to savings. We emphasized the difficulty of consolidating and reconciling information originating from various sources on workforce reductions and on costs associated with departure incentives. We also discussed a few aspects of the development and implementation of the cost-effectiveness test known as "payback," which is similar to the concept of "return on investment."

12.91 **Recommendation.** We recommended that the Treasury Board Secretariat work with departments to determine the costs of final workforce reduction and final reductions in salary and wage expenditures and ensure that Parliament is fully informed.

12.92 **Response.** The Standing Committee on Public Accounts agreed with our findings. At the end of Program Review, the President of the Treasury Board committed to providing Parliament with a detailed report on the final costs of workforce reduction and the final reductions in salary and wage expenditures.

Focus of the follow-up

12.93 Our follow-up focussed on the above-noted recommendation. We examined the files that the Treasury Board Secretariat used to support its final report, and we had discussions with Secretariat representatives. We excluded from our review the part of the recommendation applying to departments.

Conclusion

12.94 In the spring of 2001, the Treasury Board Secretariat gave us a draft report on the costs and expenditure reductions of the various departure incentive programs. In the fall of 2001, the Treasury Board Secretariat tabled this report with the Public Accounts Committee.

12.95 In our opinion, the information provided by the Treasury Board Secretariat is a reasonable report to the Public Accounts Committee on the number of recipients and the cash incentive payments. However, measuring the extent to which these incentives contributed to ongoing savings continues to be difficult.

Observations

Savings: a matter of point of view

12.96 In its report to the Public Accounts Committee, the Treasury Board Secretariat indicates that about 60,000 employees left the federal public sector under a special departure program during the target period (1995–96 to 1998–99). Of these employees, about 44,000 were from the federal public service.

12.97 The Secretariat reports that the departure incentive programs cost $4.2 billion and indicates ongoing annual savings of $3 billion since 1999. In 1998, we noted the following difficulties in trying to measure the extent to which incentives had contributed to savings:

- tracking of expenditure reductions over a four-year period during which the expenditure base had changed significantly; and
- deficiencies in the design and application of payback and the reporting structure.

12.98 In its report to the Public Accounts Committee, the Treasury Board Secretariat maintains its position that savings will continue to accrue in the future. In our opinion, the Secretariat's estimates do not completely capture the net savings, as we pointed out in 1998. However, the weaknesses of the systems and the changes in government programs make it difficult to improve the estimates.

Department of Finance—Effectiveness Measurement and Reporting (1998, Chapter 8)

Assistant Auditor General: Maria Barrados
Principal: Barry Leighton

Background

12.99 In 1998 we reviewed the extent to which the Department of Finance undertook effectiveness measurement and reported publicly on the achievement of objectives in areas where it had direct responsibilities for policies and programs. We also examined the extent to which the Department had the capacity, structures, and procedures to measure adequately the effectiveness of its policies, programs, and operations.

12.100 We found at that time a lack of clarity in information regularly provided to Parliament on the Department's policy and program responsibilities. We observed that improvement was needed in providing Parliament with clear statements of policy and program objectives and with results achieved relative to objectives. We concluded that the Department's effectiveness measurement practices were not closely integrated with the overall corporate management process, thereby resulting in only partial coverage of programs.

Focus of the follow-up

12.101 In our follow-up work, we reviewed reports prepared by the Department on the progress it had made in responding to our observations and recommendations. This included an action plan prepared in response to a Public Accounts Committee request. We also conducted interviews and examined relevant documents.

Conclusion

12.102 The Department of Finance has made some improvements, including better communicating to Parliament of its responsibilities and clarifying its programs and policy objectives. We found a significant improvement in the information the Department provides on the objectives and results of tax expenditures. Limited progress has been made in advancing its effectiveness measurement and reporting in other responsibility areas, and it has yet to improve the information it provides to Parliament on the effectiveness of many of its programs and policies.

12.103 The Department has recently established an Internal Audit and Evaluation Committee and designated a Director responsible for this function. Other efforts to increase its capacity for effectiveness measurement are still at an early stage. The integration of effectiveness measurement with the Department's overall corporate planning is not yet fully implemented.

Observations

Accountability to Parliament for results

12.104 **Communicating responsibilities to Parliament.** In 1998 we recommended that the Department ensure that the information it provided regularly to Parliament clearly and consistently identify its own responsibilities, the departments and agencies with which it shares responsibilities, and how the responsibilities are shared.

12.105 Our follow-up found that the Department has made some progress in clearly identifying its own responsibilities in public documents. In particular, we noted in 1998 that statements were not clear on the Department's role for the Canada Pension Plan (CPP) and the regulatory framework for the financial services sector. Our follow-up found that in both cases the Department has clarified its role in both its reports on plans and priorities and its performance reports.

12.106 In those cases where the Department shares policy and program responsibilities with other departments and agencies, these key public documents often do not identify the other organizations involved or how responsibilities are shared. We found few references in these documents to sources of additional information on programs and policies.

12.107 **Information to Parliament on objectives.** In 1998 we recommended that the Department provide Parliament with clear and consistent statements of objectives for the full range of its policy and program responsibilities. Our follow-up found that the Department has made some progress in providing clear statements of its objectives and these statements were consistent in various public documents. Work remains to be done to ensure that objectives reflect overall program goals rather than operational or activity-level outputs.

12.108 We followed up on three areas where we did not find objectives stated clearly and consistently in 1998. Our analysis of public documents, including the reports on plans and priorities and the performance reports, indicated some improvement in the statements of objectives for international trade and investment policy, the CPP, and the regulatory framework for the financial services sector. However, the stated objectives for these programs tend to focus on operational or activity-level outputs rather than on policy or program goals. We did note an improvement in the consistency of objectives across public documents.

12.109 **Providing effectiveness information to Parliament.** In 1998, we found significant gaps in the public reporting of results relative to objectives. In most cases, reporting focussed on specific areas of operational activity or programs but did not provide information on the achievement of objectives. We recommended that the Department review the priority it assigns to accounting to Parliament for the effectiveness of its policies and programs and take steps to address the shortcomings we identified.

12.110 As in our previous audit, we found that the Department provided the most effectiveness information for the Public Debt program. As well, in key documents the Department refers to sources of additional information for this program. As in 1998, we noted a lack of measures of Canada's performance that would allow comparisons with other highly developed capital markets. In our 2000 Report, Chapter 8, Department of Finance—Managing Canada's Debt: Facing New Challenges, we observed that the Department needed to establish a more complete range of performance measures to ensure that it has a sound basis for assessing how well the program is doing at meeting its objectives. The Department states that it is working to address these concerns as outlined in its 1999–2000 Debt Management Report. For the remaining program and policy areas, we found limited improvement in the reporting of effectiveness information.

12.111 Information on the objectives and results of tax expenditures. In 1998 we recommended that the Department identify clear objectives for each tax expenditure in terms of its intended contribution to economic, social, or other objectives; report the objectives to Parliament in the annual report on tax expenditures; report summary effectiveness information in the annual report on tax expenditures where available; and establish a schedule for publishing the annual report on tax expenditures that complements the expenditure management cycle.

12.112 Our follow-up found that the Department has made significant progress in implementing this recommendation. Starting with the subsequent annual report on tax expenditures in 1998, the Department has worked to clarify statements on objectives of individual tax expenditures. Our review of the tax expenditure provisions we examined in 1998 found that a majority now has clearly stated objectives. In addition, the tax expenditure reports include summary effectiveness information for those expenditures evaluated. We noted that in the period since our last audit only three tax expenditures had been evaluated.

12.113 In 1998 the Department agreed with our recommendation on establishing a regular schedule for publishing the annual report on tax expenditures that complements the expenditure management cycle. Of the past four reports, two were published in July, one in June, and one in September. The Department informed us that its subsequent work in the area led it to conclude that an early spring publication date is not feasible because some of the tax expenditure data are not available until December. It also stated that some of the data on projections rely on economic variables as they exist shortly before the February Budget. In addition, since the timing of the Budget or Economic Update fluctuates, the publication date for the report will fluctuate as well.

12.114 Legislative review processes. In 1998 we examined the effectiveness information that was available for three areas subject to legislative review. Our assessment confirmed that while legislative reviews had many strengths, they needed to be complemented by specific processes for effectiveness measurement and reporting. Our subsequent review of these three areas found that one had produced effectiveness information on a regular and public basis. More work needs to be done to ensure that effectiveness information is produced on a regular basis in addition to legislative reviews.

Effectiveness measurement capacity and corporate planning

12.115 **Integration of effectiveness measurement with the Department's overall corporate planning.** In 1998 we recommended that the Department ensure that there are clear links between its overall corporate planning process and its effectiveness measurement function. Our follow-up found that the Department has started to take action to address this recommendation, but that it is in the early stages of doing so. In 2001 the Department established the Internal Audit and Evaluation Committee, which includes the Deputy Minister and four assistant deputy ministers. One of its responsibilities is to ensure that the results of internal audits and evaluations are incorporated into departmental priority-setting, planning, and decision-making processes. The Committee is to approve management action plans in response to audit and evaluation reports. It plans to meet three to four times a year and as needed.

12.116 **Department's approach to effectiveness measurement.** In 1998 we expressed concern about the Department's capacity to meet its responsibilities for effectiveness measurement and reporting. We recommended that the Department ensure that its approach to effectiveness measurement meet its obligation to account to Parliament for its results.

12.117 The Department has undertaken work to strengthen its capacity to measure effectiveness. In 2001 it established the position of Director of Internal Audit and Evaluation with responsibility to co-ordinate and facilitate evaluation activities across the Department. It is also developing a plan for undertaking evaluation work, which it expects to be completed by the end of 2001. The number of staff specifically allocated to effectiveness measurement work has remained constant since our 1998 audit. Only the Tax Policy Branch has personnel dedicated to evaluation and its own work plan. Although other branches do not have dedicated personnel, they undertake effectiveness measurement on an ad hoc basis using mostly contract resources.

Indian and Northern Affairs Canada—Comprehensive Land Claims (1998, Chapter 14)

Assistant Auditor General: Maria Barrados
Principal: Joe Martire

Background

12.118 The extent of Aboriginal claims to land and resources is illustrated in Exhibit 12.3. Under the government's 1986 Comprehensive Land Claims Policy, the purpose of settlement agreements is to provide certainty and clarity of rights to ownership and use of land and resources.

12.119 Settlement agreements are generally referred to as modern-day treaties. They cover a wide range of issues such as title to certain lands, wildlife harvesting rights, participation in land and resource management, economic development, and self-government arrangements. At July 2001, 14 claims had been settled; this leaves 71 in various stages of negotiation, of which 51 relate to land in British Columbia. However, not all Aboriginal groups that have unresolved land claims have joined the established treaty process. For example, in British Columbia, about 70 bands have not entered the treaty process.

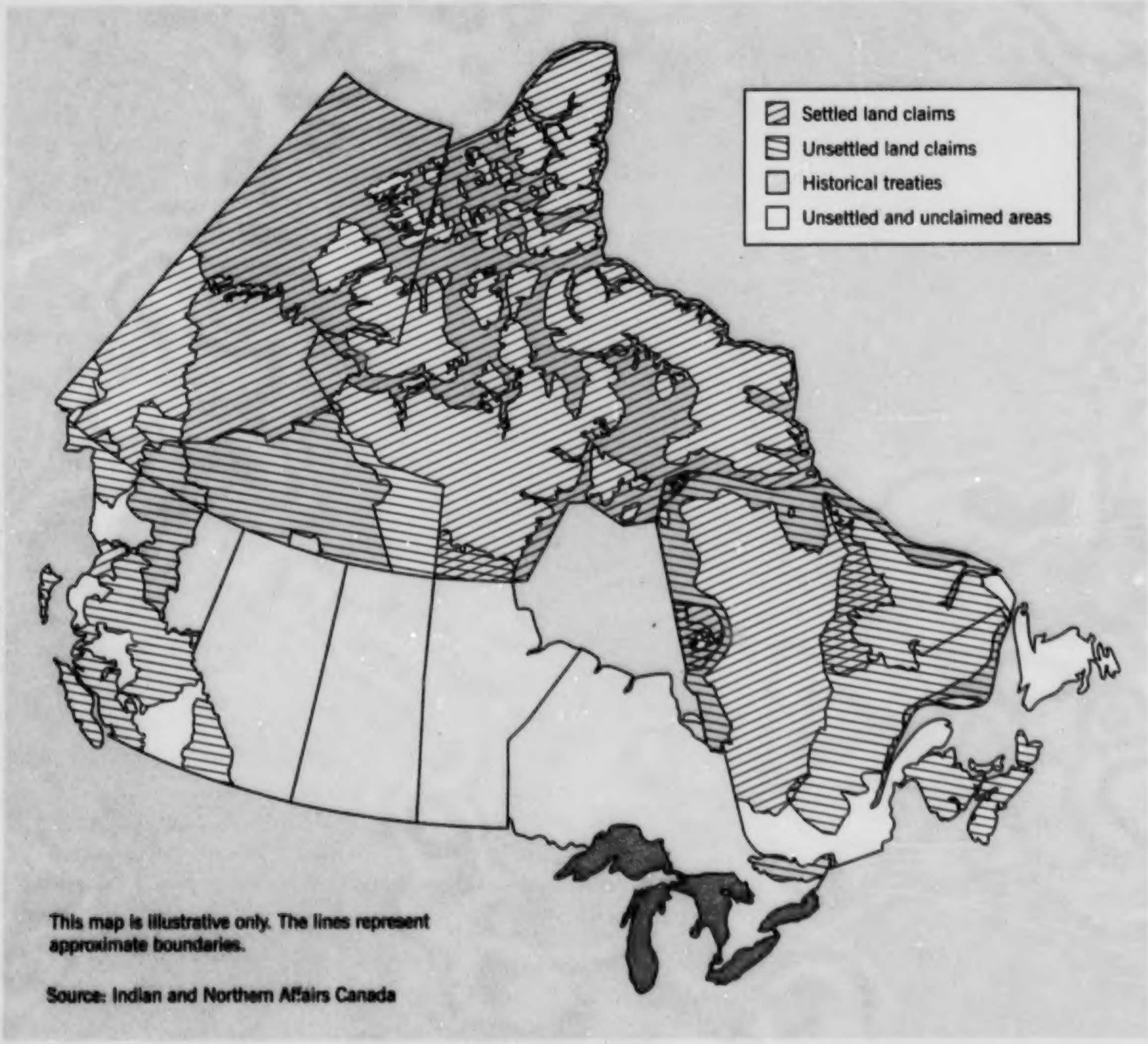
12.120 The 14 settled claims involve approximately 62,000 Aboriginal people, full ownership of over half a million square kilometres of land, a financial package of about $2 billion, and other considerations. Indian and Northern Affairs Canada plans to spend about $340 million in 2001–02 to negotiate and implement comprehensive claim settlements.

12.121 In September 1998, we reported to Parliament on the settlement, implementation, and reporting of comprehensive land claims. The audit concluded that resolving comprehensive land claims is a difficult challenge for all those involved and that there was a need to resolve a number of key issues. Specifically, our observations and recommendations included the need to take the following action:

- Enhance the achievement of certainty by addressing differing expectations relating to rights, capacity, and implementation of claim settlements.
- Expedite the treaty process and ensure adequate rigour in determining the nature and amount of assets to be included in the settlement.
- Strengthen implementation plans, improve reporting, and conduct evaluations of settlement impact.
- Report the complete costs of reaching and implementing settlements and compare them with relevant budgets.

12.122 The standing committees on Aboriginal Affairs and on Public Accounts held hearings in October and November 1998 on the results of the audit and reaffirmed our recommendations. In particular, the Standing Committee on Public Accounts stressed the need for information on outcomes achieved and complete costs.

Exhibit 12.3 Treaties and comprehensive land claims in Canada


▨ Settled land claims
▤ Unsettled land claims
☐ Historical treaties
☐ Unsettled and unclaimed areas

This map is illustrative only. The lines represent approximate boundaries.

Source: Indian and Northern Affairs Canada

Focus of the follow-up

12.123 In our 1998 audit, we examined four claim settlements finalized between 1984 and 1993, including several aspects of their implementation. We also discussed with the British Columbia Treaty Commission certain issues applicable to it.

12.124 Two claims have been finalized since the 1998 audit: the Nisga'a Treaty in B.C. and the Tr'ondek Hwech'in Agreement in the Yukon. Our follow-up work did not review these settlements in detail. We discussed with departmental officials the progress achieved in addressing the issues raised in our 1998 audit. We also reviewed written assertions and a sample of related documentation provided by the Department.

Conclusion

12.125 The Department is taking action to address most of our observations and recommendations. However, it needs to accelerate its efforts in evaluating the implementation of settlements and in capturing and reporting the full cost of reaching and implementing settlements.

12.126 We also noted that fundamental issues remain related to the current treaty negotiation approach, namely the difficulty of achieving certainty and the length of time to reach agreements. Progress in these areas depends on the political will, co-operation, and good faith of all parties concerned.

12.127 Achieving certainty in settlements continues to be a significant challenge because governments and Aboriginal groups have different expectations of what a modern treaty is and does. The slow pace of claims settlements is costly to all parties, both financially and in terms of foregone economic development. For example, as at 31 March 2001, outstanding loans to First Nations to fund their participation in negotiations totalled approximately $550 million. For a few First Nations, the amount of their negotiation loans now approaches 50 percent of expected settlement amounts and has become another impediment to settlement. In its 2001–02 *Report on Plans and Priorities*, the Department states that it expects to conclude up to 15 more final agreements over the next three years.

Observations

Achieving certainty continues to be a significant challenge

12.128 In 1998 we reported that certainty can mean different things to different parties and that there are many factors that affect the achievement of certainty. We recommended that the Department further address differing expectations of the parties relating to rights, capacity, and implementation to enhance the achievement of certainty concerning ownership and use of lands and resources.

12.129 Fundamental differences in the parties' aims for land claims have been recognized for many years. The 1985 report of the task force to review comprehensive land claims policy (commonly known as the Coolican report) noted, "The federal government has sought to extinguish rights and to achieve a once-and-for-all settlement of historical claims. The Aboriginal peoples, on the other hand, have sought to affirm the Aboriginal rights and to guarantee their unique place in Canadian society for generations to come."

12.130 The government's 1986 Comprehensive Land Claims Policy recognizes that Aboriginal groups have objected to blanket extinguishment of all Aboriginal rights in exchange for the benefits provided through settlement agreements; it states that "alternatives to extinguishment may be considered provided that certainty with respect to lands and resources is established."

12.131 In December 1997, the Supreme Court decision in the case of *Delgamuukw v. The Queen* ruled that where Aboriginal title is established, it is the right to exclusive use and occupation of land; further, governments must conduct meaningful consultations and sometimes obtain consent and pay compensation for activities that infringe on Aboriginal title. This ruling increased Aboriginal expectations concerning access to lands and resources, government recognition of Aboriginal title, and consultation and compensation.

12.132 In its 1997 response to the report of the Royal Commission on Aboriginal People, *Gathering Strength – Canada's Aboriginal Action Plan*, the Government of Canada undertook to discuss its comprehensive claims policy and process with Aboriginal, provincial, and territorial partners in order to respond to concerns about the existing policy. Policy review discussions were held between Indian and Northern Affairs Canada and the Assembly of First Nations (AFN).

12.133 In May 2000, the AFN proposed that a panel of experts be established to review the 1986 Comprehensive Land Claims policy and to make recommendations for an alternative. In July 2000, the Minister of Indian and Northern Affairs responded that, in his opinion, the existing policy is sufficiently flexible to accommodate the concerns of First Nations. According to the Department, the best way to resolve outstanding issues of Aboriginal rights and title and to address capacity and implementation issues is at individual negotiating tables where the unique circumstances of each claim are taken into account.

12.134 In 1998 the governments of Canada and British Columbia and the First Nations Summit of B.C. launched a Tripartite Review of the British Columbia Treaty Process. In April 2000, the three parties agreed to "A Statement on Certainty Principles for Treaty Negotiations in British Columbia." In October 2000, the First Nations Summit proposed a new approach for achieving certainty in treaties to the federal and provincial ministers. This Reconciliation Model for Treaties proposes that treaties recognize, affirm, and protect Aboriginal title and do not include any language that expressly or implicitly extinguishes Aboriginal title and rights. Rights not specifically included in the treaty would continue, but a First Nation would agree to only assert, exercise, and enforce its rights and title as provided in the treaty. The B.C. government does not believe that such a "non-assertion" model would bring the degree of certainty the province requires for treaties.

12.135 We have observed that the parties at individual negotiating tables continue to seek legal wording for rights provisions that are acceptable to all. For example, the certainty provisions used in the Nisga'a Final Agreement refer to modifying any Aboriginal rights the Nisga'a may have and defining the rights the parties have agreed the Nisga'a may exercise. According to the Department, any Aboriginal rights other than as set out in the Agreement are released. At another negotiation table, three independent lawyers were asked to make recommendations to the negotiator on how to best satisfy everyone's concerns about certainty provisions; no recommendation has yet been made.

12.136 The degree of certainty achieved through land claims agreements ultimately depends on the satisfaction of all parties with the results realized. Achieving certainty continues to be a challenge as parties' expectations of treaties remain significantly different. Finding ways to achieve certainty that are acceptable to all parties is critical to expediting the treaty process and ensuring that the terms of any treaty that is negotiated will be honoured.

Claims settlements continue to be slow

12.137 Since our 1998 audit, two additional settlement agreements have been finalized; five agreements-in-principle have been signed or initialled, of which two have not yet been ratified; and eleven framework agreements have been concluded. Nevertheless, in our view, the rate of progress will need to accelerate significantly if the Department is to achieve the expected results included in its 2001–02 *Report on Plans and Priorities*. In that report, the Department stated that it expects to conclude up to 15 agreements-in-principle and up to 15 final agreements over the next three years.

12.138 We noted that the time taken to reach 12 of the 14 modern-day agreements signed ranged from 6 to 25 years. For example, the Nisga'a Agreement, which came into effect on 11 May 2000, took 24 years to settle and consisted of approximately 1,100 pages of documentation spread over seven agreements. The Nisga'a Agreement is the first treaty to contain both self-government and land claims arrangements in one agreement. We further noted that 11 of the 14 signed agreements are located north of the 60th parallel. In the north, the federal government owns the land and has constitutional authority, populations are smaller, and Crown land is more available. By contrast, most of the ongoing negotiations are in the south. They require the participation of provincial governments that control most of the lands and resources, and involve the interests of more non-parties.

12.139 Indian and Northern Affairs Canada has taken some steps that could contribute to expediting the negotiation process. In December 1998, a three-year Negotiation Preparedness Initiative with funding of $29 million was approved. The Initiative was intended to enhance the capacity and expertise of Aboriginal groups that have asserted a land claim to prepare for negotiations on land and resource components of comprehensive claims settlements. Furthermore, in order to provide benefits to First Nations earlier in the process and to protect land and resources during negotiations, treaty-related measures were introduced in British Columbia in 1999. The measures can provide benefits that will be included in an anticipated final agreement or provide funds to First Nations to conduct studies and undertake economic analyses of particular areas of interest, such as forest management.

Evaluation of settlement impact is needed

12.140 Our 1998 audit recommended that Indian and Northern Affairs Canada, together with other settlement partners, ensure that implementation plans contain adequate details on time frames, project costs, and cost sharing. We also recommended that the Department address issues relating to fragmentation, completeness, and timeliness of reporting on implementation, and, together with other settlement partners, perform timely evaluations of settlement impact.

12.141 Settlement agreements reached after 1986 require implementation plans that identify certain activities to be undertaken and payments to be made to implement settlement agreements. These plans are intended to ensure that all parties have a common understanding of how the agreement will be implemented and to secure their commitment to meet their obligations. The Department believes that implementation plans need to be flexible planning tools in order to avoid the need to revise the plan when operational circumstances change. In response to our recommendation, the Department is revising its 1989 handbook for implementation negotiators and managers.

12.142 In 1998 we found that the Land Claims Obligation System (LCOS), used by the Department to report on the status of federal obligations, tracked only activities and processes, not results produced and costs incurred. In addition, the information in LCOS was too general to be used to assess the status of certain obligations.

12.143 In response to this finding, the Department is developing a new monitoring system, the Treaty Obligation System, as a possible replacement for LCOS. The Department informed us that the provincial government and the Nisga'a Nation have agreed to use this new system as a common database to monitor the Nisga'a Implementation Plan. According to the Department, the Treaty Obligation System is not expected to be fully operational for the Nisga'a settlement until late 2001 at the earliest.

12.144 In its response to the Public Accounts Committee, the Department indicated that it would develop an evaluation framework to evaluate the social and economic benefits of settlements and to consider including such information in its *Performance Report*. The Department stated that it expected to have made significant progress in developing a multi-year plan to evaluate settlements by December 1999.

12.145 The Department has conducted studies of the key expectations of various parties, including performance indicators and measurement strategies. However, it has not yet developed an evaluation framework and is not certain when the first evaluation will be completed. The Department has informed us that it is exploring various options for including an evaluation requirement in the negotiation of new agreements.

More work needed to report complete costs of reaching and implementing settlements

12.146 Our 1998 audit recommended that the Department report to Parliament the complete costs of reaching and implementing settlements and compare them with relevant budgets. The Public Accounts Committee concurred with our recommendation and called for the Department to include in its annual *Performance Report* complete costs of reaching and implementing land claims settlements; these costs should include the potential value of assets in settlement agreements, consolidated costs of other federal departments, and the costs of implementation projects and revenue and resource sharing. In its reply to the Committee, the Department pointed out that some of the Committee's suggestions would require time to implement because consultation with and agreement of other settlement partners and the development of systems to gather claims-related costs would be needed.

12.147 The Committee's recommendation on cost reporting has not yet been implemented. Although the Department is developing a report format that would provide details on its own expenditures, it has no plans to report the costs of other government departments; however, it plans to provide electronic links to other departments' financial information, as appropriate. Departmental officials believe that other government departments are responsible for reporting on the funds allocated to them by Parliament and that gathering such information would be a logistical challenge.

12.148 We continue to believe that Indian and Northern Affairs Canada should provide a leadership role in reporting the complete costs of reaching and implementing settlements. In our view, this information would enable Indian and Northern Affairs Canada, Parliament, and the public to understand the types of activities and costs related to comprehensive land claims.

Patented Medicine Prices Review Board (1998, Chapter 17)

Assistant Auditor General: Maria Barrados
Principal: Patricia MacDonald

Background

12.149 In 1998 we examined the work the Patented Medicine Prices Review Board undertook to regulate the prices of patented medicines in accordance with relevant legislation and regulations. We also reviewed whether the Board reported to Parliament complete and reliable information on the extent to which its price review activities affect prices of patented medicines, price trends for all drugs, and research and development spending by pharmaceutical patentees.

12.150 We found that the Board had contributed to the containment of patented drug prices and had taken steps to assess the impact of federal price regulation. However, other factors also had contributed to the containment of prices, and we were concerned that the Board's estimates of its savings to the Canadian health care system were overstated.

12.151 We identified issues pertaining to the legislative framework that needed to be reviewed. We observed that the Board needed to ensure that its price review decisions were clear and transparent, and to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Finally, we observed that improvements were required in the reporting of drug price trends and pharmaceutical research and development expenditures.

Focus of the follow-up

12.152 In our follow-up work, we reviewed status reports prepared by the Board on its progress in responding to our observations and recommendations. These included an action plan prepared in response to a Public Accounts Committee request. We also conducted interviews and examined relevant documents.

Conclusion

12.153 The Board has made good progress in implementing our recommendations, in particular those most directly within its control. It has taken action to improve the measurement of its activities and to enhance the public's understanding of its role and scope of jurisdiction. The Board has made some progress in checking the accuracy of price information submitted by patentees. As well, it has initiated action to ensure the clarity and transparency of its price review decisions. The Board has also explored opportunities to improve co-ordination of scientific reviews of new drugs and reviewed its reporting of drug price trends.

12.154 Implementing several of our recommendations involved reviewing the *Patent Act* or regulations, and this required the Board to consult with Industry Canada and Health Canada. The Board brought these recommendations to the attention of both departments and has taken action on most of them. The

Patent Act has been amended to allow for the Minister of Health to enter into agreements with provinces respecting distribution of funds collected through voluntary compliance undertakings. Work on addressing recommendations related to price factors and comparisons with prices in foreign countries is ongoing. An assessment of the continued relevance of reporting pharmaceutical research and development expenditures was undertaken, with no changes being made. However, no action has been taken on clarifying the jurisdiction of the Board over patented medicines whose patents are dedicated for public use. We encourage the Board to complete its implementation of our recommendations.

Observations

Impact of federal regulation of patented drug prices

12.155 Board's measurement of the effectiveness of its activities. In 1998 we recommended that the Board improve its approach to measuring the effectiveness of its activities, taking into account other factors that have an impact on patented drug prices. Our follow-up found that while the Board has not attempted to estimate savings from its activities since our audit, it has taken steps to improve its approach to measuring effectiveness.

12.156 In October 2000, the Board's Executive Committee finalized an evaluation plan that served as a starting point for identifying evaluation priorities. The plan calls for four evaluations to be completed in 2001–02 and 2002–03. Evaluation priorities are to be reviewed annually and to be included in the Board's Strategic Plan. As well, in 1999 the Board signed a Memorandum of Understanding with the Minister of Health to provide analyses and reports on expenditure trends, price levels, interprovincial price comparisons, and cost drivers facing public drug benefit plans. To date, the Board has produced several studies on these issues.

Legislative framework

12.157 Board's role and scope of jurisdiction. In 1998 we recommended that the Board continue to identify opportunities to enhance public awareness of its responsibilities. Our follow-up found that the Board completed a consultation with stakeholders, begun at the time of our audit, and in late 1998 it released the *Road Map for the Next Decade*. This document provided an outline of the measures the Board was to take to address concerns raised, including the development of a new communications plan. The Board plans to report on the evaluation of its Consultation Policy and Communications Plan in 2001–02.

12.158 Price factors. In 1998 we recommended that the Board, in consultation with Health Canada and Industry Canada, bring to the government's attention the need to review the legislation and regulations to examine the relevance of the price factors as well as the use of comparisons with prices in the foreign countries listed in the regulations. Our follow-up found that the Board has undertaken work to address this recommendation, and while the legislation and regulations have not been amended, some changes have been initiated. However, more work is needed to fully address this recommendation.

12.159 In December 1998, the Board brought this recommendation to the attention of Health Canada and Industry Canada. Health Canada indicated that this issue was being addressed by the Federal/Provincial/Territorial Task Force on Pharmaceutical Prices. As well, in 1999 the Board established the Working Group on Price Review Issues to examine the use of United States Department of Veterans Affairs formulary prices in the international price comparison, the price review process for new patented drugs, and the price guidelines for category 3 drugs.

12.160 The Working Group issued its report on the first issue in late 1999, and the Board implemented the report's recommendations to take into account the prices charged to the United States government in calculating U.S. prices for comparison purposes. The policy was effective commencing January 2000, and it is subject to a two-year transitional period. The Working Group's report on the second issue was completed in November 2000, and the Board conducted a broader consultation in 2001 on its specific proposals to implement the report's recommendations. Finally, the Working Group has begun its consideration of the review and analysis of the price guidelines for category 3 drug prices and expects to complete this work in 2002–03.

12.161 **Patent dedication.** We recommended that the Board bring to the attention of the government the need to review the legislation and regulations to clarify the jurisdiction of the Board over patented medicines whose patents are dedicated for public use. The Board told us that it had brought this issue to the attention of the government. It stated that it is not aware whether the government has considered the need to clarify the legislation and it has not pursued this issue further. The Board also stated that it has not established, and does not currently plan to establish, criteria for investigating complaints about the pricing of drug products with patents dedicated for public use as they are expected to be rare and it is difficult to foresee all possible eventualities. The Board told us it received no complaints in 1999 and 2000.

12.162 **Voluntary compliance undertakings.** In 1998 we recommended the review of legislation and regulations regarding distribution of money collected through voluntary compliance undertakings. Our follow-up found that in 1999 the *Patent Act* was amended to allow the Minister of Health to enter into agreements with provinces respecting the distribution of funds collected through voluntary compliance undertakings.

12.163 **Pharmaceutical research and development expenditures.** We recommended the review of the continued relevance of the requirement for reporting pharmaceutical research and development expenditures. In response, Health Canada conducted an assessment of the means of obtaining and reporting this information. The assessment observed some weaknesses in the research and development data reported by the Board, but it concluded that the reporting of this information was still relevant. The government has not made any statutory or regulatory changes, nor has it requested the Board to make changes to the research and development reporting requirements.

Review of prices of patented medicines

12.104 Clarity and transparency of price review decisions. In 1998 we recommended that the Board ensure that its price review guidelines are rigorously applied, or that they are revised if considered inappropriate. The Board should also ensure that in cases where exceptions are made or its guidelines are not applied, the reasons for and effects of its decisions are clear and transparent. The Board told us that the guidelines have been applied in all cases since our last audit. In 1999 and 2000, there were nine cases where prices exceeded the guidelines. Decisions on four cases were reported publicly. For the remaining five cases, it was decided, following investigations, that no further action was warranted. Although these cases were reported in aggregate in the annual report, the specifics of the results of the investigations were not made public. The Board is currently considering proposals from the Working Group to make the price review process more open and transparent.

12.105 Verification of price information. We recommended that the Board identify cost-effective means to check the accuracy of price information submitted by patentees. Our follow-up found that the Board has taken initial steps to improve the accuracy of price information. In late 1998 it published a study that examined the methods it used to verify foreign patented drug price information filed by patentees; among the observations, it found that, overall, patentees were complying with the regulations. Based on the study, the Board enhanced its verification process using the methodology developed in the study to verify the prices of all patented drug products under investigation. In addition, in January 2001 the Board's Executive Committee approved the recommendations of an evaluation of the foreign price verification process. It also included in its 2001–04 Research Agenda a plan to conduct another study to verify foreign patented drug price information filed by patentees.

12.106 Co-ordination of scientific reviews of new drugs. We recommended that the Board explore opportunities to improve the co-ordination of its work with Health Canada in performing scientific reviews to categorize new patented medicines. In response to our recommendation, the Board examined this issue through the Working Group on Price Review Issues. The Working Group concluded that there was little work that could be done to link the priority review process at Health Canada with the Board as the respective reviews are undertaken for different purposes and it would be difficult to reconcile the different approaches.

Reporting of drug price trends

12.107 In 1998 we observed weaknesses in the Board's Non-Patented Medicine Price Index (NPMPI), derived from Statistics Canada's Industrial Product Price Index (IPPI). We recommended that the Board work with Statistics Canada to improve the reporting of drug price trends. After our audit, the Board decided to stop reporting the NPMPI. It also formed a task force with Statistics Canada to reach a better understanding of the indices used to measure price changes. The task force concluded that the indices do not measure the same thing. The task force's report confirmed the decision to stop publishing the NPMPI.

Electronic Commerce: Conducting Government Business via the Internet (1998, Chapter 19)

Assistant Auditor General: Doug Timmins
Principal: Nancy Cheng

Background

12.168 A technology "Blueprint" document was developed in 1994 as a strategic framework for renewing government services using information technology. As one of its initiatives, the government committed to making electronic commerce its preferred way of doing business by 1998. Following the September 1997 Speech from the Throne that introduced the "connecting Canadians" agenda, the government also committed to becoming a model user of the information highway by 2000.

12.169 In 1998 we examined the government's progress in using the Internet for internal operations and service delivery. We concluded that progress had been made in three key areas: a public key infrastructure project for secure electronic commerce, the legal framework, and common technology infrastructures for interoperability among departments and agencies. Nevertheless, we observed several key risks and made recommendations to the government to address them.

Focus of the follow-up

12.170 Our follow-up consisted of reviewing a status report prepared by the Treasury Board Secretariat on the actions taken to address our 1998 recommendations. We also reviewed supporting documentation provided to us by the Secretariat and we held discussions with its officials. We obtained information about the Government On-line initiative but we have not audited its activities.

Conclusion

12.171 The launching of the Government On-line initiative in 2000 has changed the context substantially for our 1998 observations and recommendations. Our recommendations continue to be relevant and significant, but the required time to implement them and the complexity of some of them have changed. In summary, we observed good progress in many areas, such as developing on-line business applications and a government-wide strategy for advancing electronic commerce. Yet, much work remains to put in place common technology infrastructures to support electronic service delivery across government.

Observations

Providing leadership and sponsorship to advance electronic commerce

12.172 In 1998 we were concerned that electronic commerce for government lacked strategic direction. We recommended that its goals be defined and that senior sponsorship and a strategic plan be put in place.

12.173 The October 1999 Speech from the Throne continued with the theme of connecting Canadians. It stated: "By 2004, our goal is to be known around the world as the government most connected to its citizens."

12.174 In early 2000, the government announced a framework for Government On-line (GOL) as its new strategy for electronic commerce. The framework set the direction for delivering services electronically to Canadians at the time and place of their choosing and established parameters for implementation by 2004. It included general timelines, roles and responsibilities of departments and agencies, and oversight by the Treasury Board Secretariat.

12.175 The GOL agenda provided the focus and strategic direction that the electronic commerce initiative lacked. The President of the Treasury Board was appointed lead minister for GOL; the Chief Information Officer Branch of the Secretariat oversees and co-ordinates GOL activities centrally for 28 core departments and agencies.

12.176 We noted good progress in the development of the Government of Canada Web site. In 1998 we observed that the site was static and not user-oriented. Under GOL, significant efforts have been made to re-orient the site. In adopting a citizen-centric approach, the government anticipated needs from a user perspective. Through clustering and the use of three gateways, the site now channels searches to the respective links and sources of information.

12.177 In 1998 we also recommended that the Treasury Board Secretariat keep an inventory of electronic commerce initiatives in departments and agencies for sharing good practices and lessons learned. Through the GOL initiative, development of those initiatives was tracked and reported in the government Intranet as pathfinder projects.

Using public key infrastructure to support secure electronic commerce

12.178 In 1998 we recognized the progress made by the government in developing a management framework for establishing a public key infrastructure (PKI), including contracting and developing a technical product and drafting model certificate policies and certification practice statements. To advance the use of PKI in government, we recommended that the government involve business and program managers in identifying and developing applications requiring secure data communication, that the issue of certifying the public be addressed, and that attention be paid to project management risks for the technical product.

12.179 As part of GOL, departments and agencies have been identifying programs and business processes to be put on-line. As a result, business and program managers have been engaged in planning business initiatives and working with information technology professionals to develop applications. The Treasury Board Secretariat brought to our attention several applications that make use of PKI to provide secure data communication, such as secure messaging in government and the Canada Education Savings Grant system for communicating with financial institutions.

12.180 The 1998 audit underscored some project management risks, including the technical complexity involved in cross-certification among departments and agencies and with the public. Subsequently, the contract for the technology product was successfully completed and the final product has been delivered to the government. In 2000 a government-wide licence was obtained for the use of necessary software products in implementing a public key infrastructure. Through its secure messaging project, the government has successfully demonstrated the feasibility of cross-certification among departments and agencies.

12.181 The issue of certifying the public poses a more significant challenge, and its complexity increased as a result of the GOL agenda. Since the audit, several departments have been issuing digital certificates to some public users. In addition, the government has conducted a series of consultation sessions with private sector representatives to elicit their input on authentication services. The Treasury Board Secretariat advised us that a model for centrally managed PKI services to provide the public with digital certificates to meet GOL requirements is under development. More efforts will be required before the government will be in a position to certify the public on a larger scale, particularly in the context of GOL.

Addressing potential legal liabilities

12.182 In 1998 we also raised the issue of potential government liability through the use of the Internet to provide services or carry out transactions, especially where no contractual relationship exists and third parties choose to rely on government information. We recommended that potential liability issues be identified and addressed as the government introduces new electronic commerce initiatives.

12.183 The PKI policy was approved in 1999. It provides a governance and management structure that outlines departmental responsibilities and liabilities relating to the use of digital signatures in government. The Treasury Board Secretariat advised us that it also plans to use features of the technical product as well as notices and subscriber or service delivery agreements to mitigate risks associated with potential legal liabilities. As departments and agencies implement electronic initiatives under GOL, they will need to consider legal liability issues and take steps to manage them.

Building common technology infrastructure to support electronic commerce across government

12.184 In the 1998 audit, we noted the importance of interoperability across departments and agencies in providing seamless access to government services. We recommended that efforts in identifying and adopting technical standards be accelerated to support common technology infrastructures and provide the basis for interoperability, and that PKI standards be put in place when the cryptography product becomes ready for deployment.

12.185 The government referred to the development of its strategic information management and information technology (IM/IT) infrastructure initiative as a response to our recommendation. This initiative included the adoption of a federated architecture approach to technology infrastructure and a process that facilitates planning, design, co-ordination, and implementation of technology elements to support government-wide IM/IT capabilities.

12.186 As we noted in the past, progress in advancing information technology standards in government has been slow. The Treasury Board Secretariat indicated that it is launching a revitalization of the Treasury Board Information Technology (TBIT) standards to support common technology infrastructures. It is also preparing a revised approval process for IM/IT standards to better meet the needs of departments and agencies, including an accountability regime.

12.187 Much work remains to be done in the area of common technology infrastructure and the standards required for supporting it. Moreover, a recent study commissioned by the Secretariat to examine issues relating to the implementation of a government-wide public key infrastructure identified a number of organizational and technical issues to be addressed.

12.188 Further attention and increased oversight in developing common technology infrastructures and establishing and enforcing standards are needed to fully support seamless access to government services. The ability to interoperate across government, especially among those departments and agencies with common beneficiaries and stakeholders, is essential for the Government On-line initiative.

Transport Canada—Investments in Highways (1998, Chapter 25)

Assistant Auditor General: Hugh McRoberts
Director: Diamond Lalani

Background

12.189 Transport Canada has been the federal government's key arm for investing in provincial and territorial highways through a series of ad hoc contribution programs and several multi-year cost-sharing agreements with the provinces and territories.

12.190 In 1998 we audited investments in highways and reported our observations and recommendations in our December 1998 Report, Chapter 25. This year we conducted a follow-up to determine the progress made by the Department since our last audit.

12.191 The Audit and Advisory Services within Transport Canada conducted a follow-up audit of the recommendations that we made for the Highway Contribution Programs and reported the results in May 2001.

Focus of the follow-up

12.192 The scope of our review was restricted to identifying changes that have occurred since the end of our 1998 audit. Our work involved discussion with management of the results of the Department's internal follow-up audit. We have placed reliance on the information presented in the Transport Canada Audit and Advisory Services Report of May 2001.

Conclusion

12.193 Overall, based on the report prepared by internal audit, the Department has made satisfactory progress in carrying out our recommendations or addressing most of the issues and concerns. Since the announcement of a new highway infrastructure program, the Department has remodelled its framework for contributing to provincial and territorial highway projects.

12.194 The Department recognizes, however, that there is still work to be done. This includes completing the Management Committee guidelines, addressing a number of provincial/territorial accounting practices, enhancing functions of the Highway Contribution Management System, and specifying the expected frequency of reporting highway data by provinces and territories.

Observations

Changes in the highway contribution programs since our 1998 audit

12.195 The Department has indicated that most of the highway contribution agreements signed in 1987, or in subsequent years, had expired or were due to expire prior to 2003.

12.196 The federal 2000 Budget proposed that new highway funding be made available from the $2.65 billion Physical Infrastructure Program. In June 2000, the Minister of Transport sought Cabinet approval of the program design and funding approach for a new Strategic Highway Infrastructure Program. In March 2001, the Cabinet accepted the Minister's recommendation and approved the highway component of the Physical Infrastructure Program. The Treasury Board approved a submission from Transport Canada to fund the Strategic Highway Infrastructure Program with up to $600 million over five years.

12.197 The Department has indicated that it now has a new investment strategy, as set out in the Strategic Highway Infrastructure Program, which consists of two major components: Highway Construction and National System Integration. This program replaces the previous 1974 National Highway Transportation Policy and defines the conditions under which the federal government will now contribute to both the proposed conventional highway construction initiatives and alternative financing arrangements, including public-private partnerships and tolling schemes.

Department's progress on our recommendations

12.198 The Department has made the following representations in the Transport Canada Audit and Advisory Services Report of May 2001 (1577-00-022) that was approved by the Transport Canada Audit and Review Committee on 26 June 2001.

> With the necessary government approvals secured, the stage is now being set for the Department's redesigned approach to national highway funding. A new Performance and Accountability Framework will support the next generation of formal agreements with the provinces and territories and enable comprehensive program evaluation and reporting on results in 2005. An Audit Framework has also been prepared respecting the Treasury Board's new transfer payment policy that will govern both project and program audits.
>
> The tools and methods to manage and administer the new program have been significantly improved. With respect to the 1998 audit recommendations, we conclude that the majority of issues and concerns have been effectively addressed. A comprehensive agreement template has been developed for consistent application among all provinces and territories. This agreement now calls for formal, documented project applications that must address federal program objectives and environmental impact assessments. Applications will be also subject to closer scrutiny by the federal government employing detailed screening criteria.
>
> While the Management Committee continues as the focal point for agreement management and oversight, its role, responsibilities and procedures have been effectively strengthened. Projects approved by the Management Committee will be documented describing their nature, duration, costs and contracts. All proposed amendments to construction work, or adjustments to funding, will be subject to prior approval of the Management Committee.

> We have concluded that most of the new or revised monitoring and control mechanisms affecting environmental assessments, claims payment, cost overruns, annual audits and progress reports, and project certification, directly address the concerns raised by the 1998 audits. Equally beneficial to program administration will be the approved addition of five persons to Surface Programs for the duration of the program. We also note that the means of tracking and documenting the key milestones, decisions, and finances of each agreement and project have been improved. Enhanced information management practices, and a redesigned Highway Contribution Management System, will now ensure that program integrity and due diligence are maintained.
>
> As in 1998, the collection of relevant highway data for analysis, decision-making and reporting continues to present a challenge in 2001. At the provincial/territorial level, scarce resources and incompatible data collection practices and priorities have pre-empted the ability to provide federally requested information. However, under the new Strategic Highway Information Program (SHIP), a resolution to this data problem may be at hand. As a precondition of federal funding, provinces and territories will be required to provide minimum highway data to the federal government. Given the historic data collection problems, the Department's National Highway Information System initiative offers an opportunity to create a national database for highway information. With the support of the Council of Deputy Ministers of Transportation, and funding from Transport Canada, a feasibility study among the provinces and territories is expected to report in September 2001 on the benefits and costs of participating in this national system.

12.199 Subsequent to the approval of the May 2001 Audit and Advisory Services Report, the Department has indicated that the feasibility study will not be completed by September 2001. The work is being co-chaired by Transport Canada and Transport Quebec and will likely be considered by deputy ministers at their fall meeting next year, in September 2002.

Contracting for Professional Services: Selected Sole-Source Contracts (1998, Chapter 26)
Sole-Source Contracting for Professional Services: Using Advance Contract Award Notices (1999, Chapter 30)

Assistant Auditor General: Hugh McRoberts
Director: Jaak Vanker

Background

12.200 Two complementary principles are central to government contracting: best value and open access to contracting opportunities (Exhibit 12.4). The principle of best value is to ensure that in acquiring goods or services for the Crown, the government receives the best combination of value and price. The principle of open access gives all qualified vendors a fair chance to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

12.201 In our 1998 Report, Chapter 26 and our 1999 Report, Chapter 30, we conducted two audits examining aspects of the government's treatment of sole-source contracts for professional services.

12.202 In 1998 we audited a sample of 26 sole-sourced professional service contracts initiated by five departments: Correctional Service Canada, Fisheries and Oceans Canada, Health Canada, National Defence, and Transport Canada. Because our sample was a selected one, the results cannot be generalized statistically to the broader population of similar contracts. However, the cases were not chosen in any targeted or biased way that would have led to the sample being unrepresentative of the practices used in sole-sourcing contracts of the type we audited.

12.203 In our audit we found only 8 of the 26 contracts that we examined had satisfied one of the necessary conditions that make such awarding permissible. Indeed, in most instances it was not even clear from the contract file which exception the manager had invoked to justify sole-sourcing the contract.

12.204 We recommended that deputy ministers ensure that those to whom they delegate contracting responsibility fully understand the dual principles of government contracting policy (open access and best value) and be held accountable for adherence to them. In addition, we recommended that deputy ministers ensure that when contracts are sole-sourced, the circumstances are fully consistent with the provisions of the Government Contracts Regulations.

12.205 In 1999 we audited a statistical sample of 50 sole-sourced contracts for professional services that were let using an Advance Contract Award Notice (ACAN). National Defence, Industry Canada, Human Resources Development Canada, and the Canadian International Development Agency initiated the audited contracts.

Exhibit 12.4 Government policy on contracting

"The objective of government contracting is to acquire goods and services and to carry out construction in a manner that enhances access, competition and fairness and results in best value or, if appropriate, the optional balance of overall benefits to the Crown and the Canadian people.

Government contracting shall be conducted in a manner that will

a) stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds;

b) ensure the pre-eminence of operational requirements;

c) support long-term industrial and regional development and other appropriate national objectives, including Aboriginal economic development;

d) comply with the government's obligations under the North American Free Trade Agreement, the World Trade Organization Agreement on Government Procurement and the Agreement on Internal Trade."

Source: Treasury Board Secretariat—Contracting Policy Manual

12.206 We found that only 11 percent of the contracts we examined had a justification for sole-sourcing on file that complied with the conditions stipulated in the Government Contracts Regulations.

12.207 Managers are supposed to make this determination, justify it, and document it before deciding to sole-source and before posting an ACAN. However, in 89 percent of the cases we examined, the uniqueness of the contractor was either not determined at all (that is, management was fully aware that the firm selected was not unique) or was unsupported in fact. We made a number of recommendations directed at the Treasury Board Secretariat.

12.208 Both chapters were the subject of a hearing by the Standing Committee on Public Accounts and resulted in subsequent reports by the Committee—Report 28 (36th Parliament) and Report 12 (37th Parliament) respectively. The government has tabled responses to the recommendations made by the Committee in each of the reports.

Focus of the follow-up

12.209 Our follow-up comprised reviewing progress reports and supporting documentation supplied by the Treasury Board Secretariat, Public Works and Government Services Canada (PWGSC), and other departments and agencies; conducting interviews; and performing analysis to assess the reliability of the progress reports supplied to us. We specifically examined changes in policies for contracting for services that were using either an ACAN or the non-competitive approach. Our work did not extend to seeking corroboration for the assertions made to us.

Conclusion

12.210 Our recommendations in the two chapters addressed five areas: training, policy clarification, enhanced recourse, management oversight, and accountability (Exhibit 12.5).

Exhibit 12.5 Our recommendations addressed five areas

Area	Recommendations (paragraph references)	
	1996 Report Chapter 26	1999 Report Chapter 30
Training	26.59	30.85
Policy clarification		30.91
Enhanced recourse		30.93
Management oversight	26.60	30.86, 30.88 and 30.89
Accountability	26.59	30.85 and 30.89

12.211 The Treasury Board Secretariat, PWGSC, and most of the departments and agencies have described the steps that they have taken to address deficiencies identified by the Office and the government's standing committees. Their reports indicate that significant action has been taken in the areas of training and policy clarification. However, the Treasury Board Secretariat continues to reject our recommendation on enhanced recourse for disputes related to contracts that fall outside the trade agreement related to procurement.

12.212 The government states that it has taken steps to improve management oversight and accountability for contracting through Results for Canadians and the new Internal Audit and Active Monitoring Policy. In addition, individual departments have taken steps to improve their practices in these areas. However, in our view, the government's actions have not adequately addressed our concerns.

Observations

Professional Development and Certification Program under way

12.213 To ensure that contracting authorities fully understand the objectives of government contracting, the Professional Development and Certification Program for procurement specialists was recently launched. The program is composed of two components: continuous learning and professional certification.

12.214 Sixteen courses that address the critical skill requirements have been developed and are now available. These courses cover Government Contracts Regulations as well as policy considerations that form the government's contracting management framework.

12.215 The professional certification component is under study.

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12.214 Sixteen courses that address the critical skill requirements have been developed and are now available. These courses cover Government Contracts Regulations as well as policy considerations that form the government's contracting management framework.

12.215 The professional certification component is under study.

12.216 According to the Treasury Board Secretariat, this new program complements departmental in-house courses and the ongoing training carried out by the Secretariat and key partners including PWGSC; the program is also in keeping with the government's Modern Comptrollership initiative.

Policy clarification

12.217 In 1999 there was a lack of guidance to departments on how the challenge process for ACANs was to be conducted. We recommended that this issue be addressed. The new Advance Contract Award Notice policy and the Best Practices—Guide for Managers is now available on the Treasury Board Secretariat Web site at www.tbs-sct.gc.ca.

12.218 As part of the Procurement Reform initiative, adjustments to the ACAN policy have been made and are communicated in the Best Practices—Guide for Managers. The new practices include the following:

- principles to guide the review of a supplier's statement of capabilities;
- clear timelines for posting the notices;
- clear language in the notices that improve suppliers' understanding of the work to be performed, the process, and how they may proceed;
- guidance to improve the quality of information received from suppliers;
- elimination of words that may have discouraged suppliers from expressing their interest in work identified in an ACAN; and
- guidance to ensure that, in the event that a statement of capabilities is rejected, that decision will not be made by the same official(s) who originally decided to proceed through the ACAN process.

12.219 In addition, a number of key departments have issued their own procedural clarifications. It is too early to assess the extent to which, under the revised policy, ACANs may play a role beyond adding transparency to what we view as an otherwise non-competitive process.

Enhanced recourse

12.220 For contracts that fall outside one or more of the trade agreements, the potential supplier's recourse on issues related to the procurement process is to appeal back to the very department whose actions are the object of the appeal. The supplier may also follow the potentially very costly route of taking the matter to the courts.

12.221 The Treasury Board Secretariat believes that the current avenues of recourse are sufficient and continues to reject our recommendation that an independent dispute resolution mechanism be established.

Management oversight

12.222 The results of both audits led us to believe that closer management oversight of the contracting process, particularly as it related to the decision to sole-source, was needed. We made a number of recommendations to encourage this.

12.223 Most departments have a process by which some of their contracts are subject to review by a management Contract Review Committee. Generally, however, this committee reviews only contracts let directly by the department. For most departments and agencies, their major contracts are let by PWGSC, the contracting authority for the largest number and value of service contracts. In most instances, such contracts are not subject to review by the departmental Contract Review Committee, and PWGSC has no corresponding structure. Apart from normal management supervision, PWGSC has a limited review mechanism in place, but it applies only to the very largest contracts.

12.224 In general, government managers believe that accountability for contracts issued by PWGSC is unclear and, accordingly, management oversight of these contracts is weak. Where PWGSC is the contracting authority, most departments do not carry out further reviews of the solicitation procedure used and hold PWGSC accountable for the sourcing decision. Although contracting officers at PWGSC may seek additional information from the originating department in support of the sourcing decision, they in turn view the department as being responsible for that information and its relevance to the decision. The result is that both PWGSC and the originating department work on the assumption that the other is exercising the appropriate oversight.

Accountability

12.225 The Treasury Board Secretariat agrees that departmental management is responsible for ensuring compliance of their contracting procedures with the Government Contracts Regulations and with our recommendations that departmental management be held accountable for this result. However, accountability requires regular and credible information on performance. In the area of contracting, such information is not currently available. Thus, to ensure that some key performance information would be available, we recommended that in departments with significant levels of sole-sourcing (more than 50 contracts for over $25,000 per year), the Treasury Board Secretariat require that internal audit conduct annual assessments of the compliance of these contracts with the regulations. The Secretariat rejects this recommendation, claiming that it is neither appropriate nor cost-effective. We have been informed that in some departments internal audit has planned ad hoc audits of contracting.

Revenue Canada—Underground Economy Initiative (1999, Chapter 2)

Assistant Auditor General: Shahid Minto
Principal: Barry Elkin

Background

12.226 In our 1999 audit of the Underground Economy Initiative in Revenue Canada (now the Canada Customs and Revenue Agency), we made several observations and recommendations. These focussed on the need to accurately report the tax impact of the Initiative's enforcement activities, such as audits; the need to maintain a balanced approach that incorporates activities to promote voluntary compliance; and the need to involve other federal departments and other partners in sharing information to better deal with the underground economy.

12.227 In particular, we observed that over the first five years of the Initiative the income tax impact attributable to the detection of unreported income by the Initiative's audits was difficult to determine, but it was likely significantly less than the $300 million reported.

Focus of the follow-up

12.228 Our follow-up examined the commitments made in the Agency's response to the 1999 audit recommendations. We also reviewed the status report prepared by the Underground Economy Audit Directorate on the progress in addressing our recommendations up to September 2001, as well as other internal reports provided to us. We conducted limited interviews in Ottawa with the Manager of the Underground Economy Audit Directorate.

Conclusion

12.229 Since our 1999 audit, the Agency has continued to work on addressing the recommendations. The Initiative continues to operate at approximately the same level of resources as in the period covered by the audit, including about 770 audit staff (25 percent of the Agency's entire Small and Medium Enterprises compliance resources). The Initiative also continues to carry out the same types of activities, namely audits and activities to promote and assist compliance of businesses and the public. Improvements have been made in broadening the number of sectors for audit attention, maintaining and strengthening the activities to promote voluntary compliance, and continuing to provide assistance to business in maintaining good books and records.

12.230 Three recommendations continue to need attention by the Agency. These include the following:

- identifying and reporting additional performance indicators to indicate improvements in overall compliance by taxpayers;
- clearly identifying and reporting the additional tax received as a result of the detection and reassessment of unreported income; and
- targeting high-risk files for audits of unreported income.

12.231 The third recommendation is of particular concern since 60 percent of the Underground Economy Initiative audits fail to reveal any additional unreported income. The current level of additional income being reassessed may indicate either that the Initiative has had a positive effect on improving compliance behaviour or that the selection of files for audit can still be improved.

Observations

Activities to promote compliance

12.232 In 1999 we noted that it was important to complete the social research to determine whether social marketing activities could be a valuable tool to combat the underground economy. The Agency completed the research but at the time of our follow-up had not carried out a broad-based social marketing campaign. The research did confirm the desirability of communicating messages through the home renovation sector to consumers, encouraging them not to participate in the underground economy. Fifteen hundred contractors participated in seminars presented in 2000–01 by the Canadian Home Builders Association and the Agency to assist them in delivering this message to consumers. A decision is still to be made on undertaking a further consumer campaign in the home renovation sector.

12.233 Activities to promote voluntary compliance by businesses were part of the multi-dimensional and balanced approach of the Agency's strategy to deal with the underground economy. In 1999 we noted that the number of community visits had declined. Over the past two years, the Agency has strengthened these activities. It has carried out many more community visits and implemented a national program to assist business taxpayers in meeting their obligations to keep good books and records. The Agency has also conducted on-site visits to help companies implement the Contract Payment Reporting System.

Work continues on identifying data sources

12.234 External data sources are a key to identifying unreported income and we recommended that the Agency collaborate with other governments and other partners to access these sources. Since the audit, additional data have been received from provincial and municipal governments while ensuring that the *Access to Information and Privacy Act* is respected. The Agency is continuing to work on identifying other sources of data on unreported income; however, there is still an outstanding problem in matching these data to tax return information because of the lack of a personal identifier on the data.

Sector profiles completed

12.235 Auditors need good background information on the industry sectors that they are auditing. The Agency has addressed our recommendation to complete the sector profiles for the four industry sectors initially focussed on by the Initiative. It has also produced 15 new sector profiles. We further recommended that the Agency reconsider the Initiative's audit focus and include high-risk taxpayers in all sectors. Currently, 50 percent of the underground economy resources are still dedicated to the construction/home renovation and hospitality sectors. Since March 2000, each tax service office has been able to utilize the other 50 percent to address up to three other high-risk sectors as long as they meet certain criteria.

Reporting of additional income and tax

12.236 In 1999 we attempted to identify the tax results from the Underground Economy Initiative as distinct from other ongoing activities or those carried out by other agencies. In particular, we were interested in clearly identifying the additional unreported income identified and the income tax reassessed by the underground economy audits. However, we found that this was difficult since the Agency's systems did not record these data. The audit estimated that the additional tax for the first five years would be less than the $300 million that the Agency reported. We recommended that the additional income and the additional tax from the underground economy audits be clearly recorded and reported by the Agency.

12.237 Since 2000–01 all offices are identifying the additional unreported income detected by the underground economy audits and it is now reported on a national basis. The unreported income for 2000–01 was $200 million. The tax resulting from this additional income is not yet separately reported in the Agency's performance information. The estimated tax could be $34 million.

Selection of audit files

12.238 Based on our review of the underground economy audit files, we recommended that the targeting and selection of audit files be improved. The Agency informed us that it has continued to enhance its targeting of high-risk files for unreported income by computer-assisted risk assessment and data matching, the use of informant leads, and new reporting systems. However, our review of the performance data provided for 2000–01 indicates that only 40 percent of the completed audits have identified any additional unreported income.

Better performance indicators needed

12.239 Since the activities in the Underground Economy Initiative were broad-ranging and somewhat specialized, we recommended that performance indicators be developed to report the results of these activities. For example, since some activities are meant to encourage compliance, information on changing attitudes to compliance may be important to report. The Agency agreed in its response that a wide range of performance indicators was needed to measure and report on the performance of the Initiative activities and on their long-term effects on compliance.

12.240 The performance indicators currently used for reporting results of the Initiative's activities cover fiscal impact, efficiency, quality service and client education, responsible enforcement, and visibility/education. The indicators do not monitor change in compliance behaviour, which is the objective of the non-audit activities of the Underground Economy Initiative. It is therefore not clear whether compliance behaviour has improved since the start of the Initiative.

Statistics Canada—Managing the Quality of Statistics (1999, Chapter 3)

Assistant Auditor General: Maria Barrados
Principal: Barry Leighton

Background

12.241 In 1999 we examined the extent to which Statistics Canada assesses the adequacy of quality management systems and practices in its statistical programs to ensure that it has the information needed to manage and report on quality. We also reviewed Statistics Canada's self-assessments in four selected surveys to determine whether they provide the Agency with reasonable assurance of the adequacy of quality management systems and practices. Finally, we looked at whether Statistics Canada appropriately informs users about data quality and the methodology used to develop the statistics.

12.242 We found that the Agency employed a number of formal quality assessment mechanisms, but that individual programs did not apply them consistently. We concluded that the mechanisms did not provide systematic, transparent information on the adequacy of quality management systems and practices in the Agency's statistical programs or on the level of quality achieved.

Focus of the follow-up

12.243 In our follow-up work, we reviewed documentation provided by Statistics Canada on actions taken in response to our recommendations. We also conducted interviews with Agency management.

Conclusion

12.244 Statistics Canada has made good initial progress in implementing all of our recommendations. Since 1998 Statistics Canada has better integrated its approach to managing quality in its statistical programs. As part of this effort, it has developed a revised quality assessment mechanism that will be applied to all programs. It has also taken steps to implement recommendations from its 1998 self-assessment of the Uniform Crime Reporting Survey (UCR) in order to correct weaknesses it identified. In addition, the Agency has begun to include more information on statistical quality in its *Performance Report*. Finally, Statistics Canada has revised its Policy on Informing Users of Data Quality and Methodology and started to apply this policy. However, the Agency needs to maintain momentum to ensure that the initiatives begun to correct the weaknesses our 1999 audit identified are completed.

Observations

Corporate assessment of quality

12.245 Application of formal assessment mechanisms. In 1999 we recommended that Statistics Canada ensure that formal quality assessment mechanisms are applied consistently so that they provide systematic information on the adequacy of quality to management systems and practices in individual statistical programs and, to the extent possible, information on the quality achieved. Statistics Canada has developed a revised formal quality assessment mechanism designed to be applied consistently to all statistical programs. The Integrated Program Reporting (IPR) process consists of three levels of assessment: an Annual Consolidation of Indicators (ACI); a Biennial Program Review (BPR); and a Quadrennial Program Review (QPR). The ACI is the responsibility of the Corporate Planning Division, which prepares tables from central systems such as human resources and financial systems. The BPR and the QPR are more detailed reviews of the programs prepared by managers. For 2000–01, the Agency planned to complete BPRs or QPRs for 21 of 49 statistical programs; it completed nine (five BPRs and four QPRs). Of the remaining 12, 10 (six BPRs and four QPRs) are being finalized, and 2 were postponed until 2001–02. According to Statistics Canada's current schedule, reviews of approximately 40 percent of programs will be completed by the end of 2001–02.

Statistics Canada's self-assessment of four surveys

12.246 **Wider application of self-assessment technique.** In 1999 we recommended that Statistics Canada review the potential for a wider application of an enhanced self-assessment technique as one component of the formal processes it uses to assess quality. Statistics Canada has acted on this recommendation. The BPR and QPR of the Integrated Program Reporting process incorporate self-assessment techniques similar to those used as part of the Agency's 1998 self-assessment process.

12.247 **Self-assessment of Uniform Crime Reporting Survey.** In 1999 we observed that the recommendations of the Agency's self-assessment of the Uniform Crime Reporting Survey (UCR) were more important than the self-assessment suggested and deserved the attention of senior management. This survey is currently in a period of transition. Prior to 1988, the UCR survey consisted of aggregated data of incidents of crime (UCR1). Since then, the Canadian Centre for Justice Statistics has been working closely with police forces and vendors of police records management systems to enable forces to transmit incident-based data (UCR2). National coverage of UCR2 is at approximately 50 percent. As a result, UCR2 does not constitute a representative survey of Canada. The self-assessment of the UCR survey done as part of the 1999 audit recommended specific analyses to determine the impact of imputation of missing data. Statistics Canada has acted on this recommendation and developed monthly and annual imputation rates.

12.248 Implementation of UCR2 has depended largely on accessibility of information technology. Affordability of computer systems and amalgamation of jurisdictions have accelerated the implementation of UCR2. There are two large forces, the OPP and the RCMP, and a number of very small forces that are not yet included in the UCR2. Statistics Canada told us that inclusion of the OPP and the RCMP in the UCR2 will add approximately 40 percent to the total survey coverage. The OPP has implemented a UCR2-compliant records management system in most of its jurisdictions and is currently sending test data to Statistics Canada to verify the system. The OPP personnel responsible for implementing the new system stated that yearly UCR2 data from all OPP jurisdictions should be available for 2002. The

RCMP expects to implement a UCR2-compliant system over the next five years.

Reporting performance to Parliament

12.249 In 1999 we recommended that Statistics Canada improve the coverage and content of information on statistical quality in its annual *Performance Report* to Parliament by drawing on quality information available from internal assessment and reporting systems. We found that Statistics Canada's 1999–2000 *Performance Report* outlines the components of quality defined in its Quality Assurance Framework and uses this framework to discuss the quality of selected programs. The Report systematically reviews several products for relevance, accuracy, timeliness, accessibility, interpretability, and coherence. These six dimensions of information quality define a product's "Fitness for Use," one of the four aspects of performance described in the Framework.

Informing users about data quality and methodology

12.250 In 1999 we recommended that Statistics Canada ensure that its Policy on Informing Users of Data Quality and Methodology is applied consistently across products and dissemination media. We also recommended that, in informing users of data quality and methodology, Statistics Canada use clear and standardized headings in all printed and electronic documents for sections that provide information on data quality and methodology or that refer the user to a source where such information can be found. We further recommended that the Agency establish a flexible disclosure framework to define the contents of the data quality and methodology section in individual statistical products and related documents, to ensure that the intent of the Policy is met. The framework should allow for variations in the depth and breadth of the information provided, depending on the program, product, or medium of dissemination.

12.251 Our follow-up observed that Statistics Canada has taken steps to address these recommendations. It has created an Integrated Meta Database (IMDB) that is intended to serve as its flexible disclosure framework. Data from existing metadata repositories were converted into the IMDB in November 2000, and active follow-up began January 2001. Between January and the end of July, 46 percent of the 366 active surveys were updated to conform with the Policy on Informing Users of Data Quality and Methodology. This represents 78 percent of the monthly surveys, 50 percent of the quarterly surveys, and 35 percent of the annual surveys. Also, the IMDB has been updated to satisfy the Policy for nine out of the ten mission-critical surveys. Statistics Canada expects to have updated IMBD information on 95 percent of surveys by the end of 2001–02, with the exclusion of information on concepts and variables. Information on concepts and variables measured will be added to the IMDB and upgraded during a later phase of the development.

12.252 The Agency's Methods and Standards Committee revised the Policy on Informing Users of Data Quality and Methodology to include the use of standardized headings covering quality and methodology. The IMDB will enable Statistics Canada to use clear and standardized headings in all printed and electronic documents for sections that provide information on data quality and methodology. An internal audit on the extent to which statistical products comply with the Policy on Informing Users of Data Quality and Methodology is currently being planned and is expected to be completed by 2001–02.

Integrated approach to managing quality

12.253 In 1999 we recommended that Statistics Canada make its quality-related policies, guidelines, and systems more coherent and cohesive by reconciling differences in definitions of quality and co-ordinating the requirements for internal documentation and external reporting. Statistics Canada has reconciled differences in definitions of quality by consistently applying its six-dimensional definition of product quality, which assesses the product's Fitness for Use. As mentioned earlier, Statistics Canada is incorporating the definitions of quality from the Quality Assurance Framework into the IMDB specifically for the purposes of co-ordinating the internal documentation and external reporting.

12.254 We also recommended that Statistics Canada co-ordinate the development of the Integrated Meta Database with other quality-related initiatives and take steps to ensure the ongoing completeness and reliability of the database. The Agency is currently integrating the IMDB with other quality-related initiatives. Specifically, when performing the Annual Consolidation of Indicators (ACI), the Corporate Planning Division plans to generate assessments of quality that are standardized across programs, using the data stored in the IMDB.

12.255 We further recommended that Statistics Canada assign to a corporate focal point the responsibility for promoting an integrated, consistent approach to developing and implementing quality-related initiatives throughout the Agency, including the assessment and reporting of quality. Statistics Canada has made organizational changes to create corporate focal points of responsibility for quality-related initiatives. At the time of our 1999 audit, the responsibility for evaluations rested primarily with managers of individual programs. Since then, several changes have been made: the Corporate Planning Division is responsible for all ACIs; the mandate of the Methods and Standards Committee has been revised to make it responsible for ensuring that the Agency's quality management processes are appropriate, coherent, and used; and all Quadrennial Program Reviews are presented to the Program Evaluation Committee.

Agriculture Portfolio—User Charges (1999, Chapter 11)

Assistant Auditor General: Doug Timmins
Principal: Ellen Shillabeer

Background

12.256 Our 1999 audit looked at the management of user charges in three organizations in the Agriculture Portfolio—Agriculture and Agri-Food Canada (the Department), the Canadian Grain Commission, and the Canadian Food Inspection Agency. Within the Department, we examined user charges in the Prairie Farm Rehabilitation Administration, Market and Industry Services Branch, and the National Income Stabilization Account program of Policy Branch. We looked at only those fees for services provided to users outside the government.

12.257 At the time of our audit, these organizations had made progress toward meeting the requirements of the government's 1997 policy on user charges, but they were losing momentum, and user charges were not being updated as programs changed. The organizations did not meet all of the requirements of the policy. They needed to improve their management of user charges in a number of areas, including costing their services, assessing the impact of fees, establishing formal appeal and dispute resolution processes, and integrating user charges into their strategic planning.

12.258 As noted in the audit, the Minister of Agriculture announced a moratorium on new or increased user charges in November 1996. In the spring of 2000, the Minister extended the moratorium for all three organizations—to the end of 2002 for Agriculture and Agri-Food Canada and the Canadian Food Inspection Agency and 2004 for the Canadian Grain Commission. In their response to our chapter and in subsequent parliamentary committee hearings, the organizations committed to taking action, within the limits imposed by this moratorium.

12.259 Parliamentarians have continued to express interest in the issue of user charges, and the agriculture committee of the House of Commons has held hearings on this topic. The House of Commons Standing Committee on Finance has also examined cost recovery issues and originally tabled its report in the House in June 2000.

Focus of the follow-up

12.260 We conducted our follow-up by reviewing status reports, provided by each of the organizations, which describe actions they took to address our recommendations. This was supplemented by further review of additional documentation and by interviews with departmental officials. We also reviewed the government response to the Report of the Standing Committee on Finance.

Conclusion

12.261 The organizations have made limited progress in the two years since our audit—in part, because of the government's continuing moratorium on new or increased fees. They also hesitated to take action before the Treasury Board Secretariat finished a review of the government's Cost Recovery and

Charging Policy. However, even in areas where action was possible, such as improving their understanding of the costs of providing their services, we found limited progress.

12.262 We will continue to monitor the actions taken by these organizations in coming years to determine their progress on our recommendations.

Observations

Barriers to taking action

12.263 All three organizations indicated that the continuing moratorium has had an impact on their ability to make changes in their management of user charges. For example, since the moratorium does not allow for new or increased fees, the organizations have not had the opportunity to demonstrate an improvement in the information they provide to the public on the likely impact of proposed fees. The moratorium has also affected other aspects of the management of user charges, such as the responsiveness of fee structures, the inclusion of user charges in strategic planning, and appeal and dispute resolution processes. However, there are other areas where these organizations could be doing more to prepare for the eventual end of the moratorium; we explain these areas further in the following sections.

12.264 In addition to the moratorium, the organizations cited a second barrier to taking action; they are awaiting a revised policy on user charges from the Treasury Board Secretariat. The Secretariat's review of the government's 1997 Cost Recovery and Charging Policy was originally scheduled to be completed before 2000, but the review of the policy and any changes to it are not expected to be in place before early 2002. Departmental officials told us they are reluctant to implement changes that could be contrary to the new policy.

Analysis of current situation lacking

12.265 In our 1999 audit, we considered the moratorium period as an opportunity for these three organizations to reassess their current position and plan improvements. They have done this, but only to a very limited extent. While the moratorium prevents them from introducing new fees and severely limits their ability to change existing fees, they could have better identified changes that are needed to prepare for when the moratorium is lifted.

12.266 In its published response to our original audit, the Canadian Food Inspection Agency committed to focussing its efforts on simplifying its fees. This has not happened and the number of fees remains at about 1,600, although the Agency has reiterated its intention to simplify its fee structure. Also, while the Agency continues to acknowledge that there are known problems with its user charges, such as different commodity groups paying different proportions of the costs of providing similar services, the Agency has not conducted any formal analysis to determine how the fees need to be changed. It has developed a draft cost recovery policy and strategic plan that outline the Agency's plans for costing and consultations before resuming consultations on user charges in 2003. The Agency has also hired an economist to conduct economic impact assessments. However, it is too early to determine the results of these efforts.

12.267 We noted in our audit that the moratorium had prevented the Canadian Grain Commission from taking action on the recommendations of its 1999 program review to better align its fee structure with its underlying costs. Since the moratorium has continued, this is still the case. However, the government has taken this situation into account and approved $83 million in additional funding for the Canadian Grain Commission to ensure that their mandatory fees remain frozen until 2004.

12.268 One branch of Agriculture and Agri-Food Canada has made progress despite the moratorium. The Prairie Farm Rehabilitation Administration has completed relevant studies for two of its major programs. The first study, focussing on the southwest Saskatchewan irrigation projects, determined the proportion of benefit the public receives from the service and the portion of the private benefit that should be recovered from the users. The second study developed an economic framework for cost recovery in the branch's community pastures program, including the optimum cost recovery level for this program.

Minor improvement in costing methods

12.269 In 1999 we emphasized the need for solid costing practices in order to know whether user charges are set at appropriate levels. All three organizations have made significant changes to their accounting systems, which now have the capacity to track and implement more sophisticated costing methods. The Canadian Food Inspection Agency indicated that it has done some work on improving its resource allocation tracking system and activity tracking system. The Canadian Grain Commission and Agriculture and Agri-Food Canada continue to work on their systems. However, efforts to date have been focussed on getting their new systems up and running, and the ability of these new systems to capture and analyze costing information has not been fully activated. More effort is needed in this area.

Consultations stalled between the Canadian Food Inspection Agency and users

12.270 Our 1999 audit found that, in general, the consultation process between the Canadian Food Inspection Agency and users had improved over the previous five years. During the moratorium the Agency has continued to hold consultations with stakeholders to share information on program developments; however, consultations on user charges have stalled. Thorough consultations are required for progress in areas such as identifying changes needed in fee structures and developing further service standards; yet the Agency has no plans to conduct in-depth, sector-specific consultations with industry on user charges before 2003. Both the Department's Prairie Farm Rehabilitation Administration and the National Income Stabilization Account program have continued to hold regular consultation sessions. The Canadian Grain Commission has also held annual meetings with its stakeholders.

Recent work on cumulative impact

12.271 Led by Agriculture and Agri-Food Canada, the organizations have made good progress in addressing two recommendations on the cumulative impact of user charges. In 1998 the Department examined the impact of selected federal cost recovery initiatives on the agri-food sector. Building on this work, the Department is now completing a study that outlines an approach for assessing the cumulative impact of the various proposed fees for programs in the agriculture and agri-food sector.

Little progress on service standards

12.272 In 1999 we noted that, with few exceptions, the organizations did not use service standards and/or measures of client satisfaction as management tools to assess the extent to which their services were meeting customer expectations. We found that little has changed in the past two years in all three organizations. Service standards are the exception, not the rule. And those standards that are in place are not being rolled up to an organizational level. This is an area that could be addressed during the moratorium.

Some work on guiding principles

12.273 In 1999 we highlighted the importance of guiding principles for establishing user charges—both to ensure consistency across an organization and to provide user groups with important information. This is an area where we expected progress. While both Agriculture and Agri-Food Canada and the Canadian Food Inspection Agency have begun to develop a framework and a strategic plan for the management of user charges, these initiatives are still in the draft stages and have not yet received senior management approval. The Canadian Grain Commission continues to apply the guiding principles it has had in place for some time, but has been unable to fully apply these principles to its mandatory services because of the moratorium.

12.274 Members of the three organizations agreed in August 2000 that the most effective way to approach the challenge of improving the management of user charges is to work together to develop guiding principles, a generic framework, and general guidelines for managers. Agriculture and Agri-Food Canada drafted a framework for the management of cost recovery that is intended to be applied by the three organizations. This approach recognizes that it is the same users (primarily farmers and industry in the agriculture and agri-food sector) who pay fees to the three organizations. While the Canadian Grain Commission and the Canadian Food Inspection Agency have, in principle, agreed to proceed with the development of this framework, progress has been slow while the Department awaits the results of the Treasury Board Secretariat policy review.

National Defence—Hazardous Materials: Managing Risks to Employees and the Environment (1999, Chapter 13)

Assistant Auditor General: David Rattray
Principal: Peter Kasurak

Background

12.275 In 1999 we examined how National Defence managed hazardous materials such as flammable substances, corrosive products, and ammunition. The Department used over 6,000 hazardous products and estimated that at least a quarter of its 80,700 full-time employees came into frequent contact with hazardous chemicals.

12.276 Although departmental policies, plans, and procedures at the national level indicated an awareness of the legal framework and best practices for hazardous materials management, implementation at the base and unit levels was inconsistent. We found shortcomings in compliance with laws and regulations, in application of audit protocols and methodologies, and in application of compliance management systems aimed at promoting continual improvement.

12.277 The Department responded positively to our recommendations and indicated it would take action to address the concerns raised in our audit.

Focus of the follow-up

12.278 The objective of our follow-up was to determine the status of our recommendations and identify actions taken and improvements made by the Department. We interviewed departmental officials and reviewed key documents and reports.

Conclusion

12.279 The Department has taken steps to address our concerns. It has developed action plans for each recommendation and has made some progress. However, it has carried out few recommendations fully, and it has revised and extended many of the completion dates for its action plans.

12.280 Personnel shortages have contributed to the slow progress. As well, the Department's main focus has been the preparation of its second sustainable development strategy and its environmental management system at the national level. Officials indicated that these two documents will provide much of the direction for departmental progress in addressing our concerns.

Observations

Information systems are improving

12.281 We recommended that National Defence provide its employees with safety and environmental information on hazardous materials, and that it implement inventory systems that contain standard information on hazardous materials.

12.282 The Department has taken steps to update and improve the information it provides to personnel. A project is under way to amalgamate workplace information management systems into a Web-based system that will also incorporate a centralized database for current and historical Material Safety Data Sheets for hazardous materials.

12.283 The project includes a cross-functional team to identify minimum standard requirements for the Web-based system. This system is intended to allow employees to access a preferred products library of less-hazardous products and to directly link them to the Departmental Inventory Management System for accurate and up-to-date inventory information.

12.284 Training courses for the Workplace Hazardous Materials Information System (WHMIS) have been updated and the tracking system has been standardized. These courses provide training on identifying and interpreting hazardous information and symbols. The new tracking system ties the training records to the Department's National Training Database, personnel files, unit employment record files, and Base Safety Officer files.

Slow progress in monitoring effluent

12.285 Our audit identified the need for an assessment of liquid effluent and air emissions at National Defence bases to ensure that hazardous materials were not contaminating the environment.

12.286 The Department's second sustainable development strategy, dated December 2000, commits the Department to issuing national guidance on effluent monitoring, developing and carrying out an effluent monitoring plan for storm sewers, and periodically testing discharges to municipal sewers for conformance with local standards. The strategy also commits the Department to developing a national air emissions strategy.

12.287 The Department participates in an interdepartmental committee that, among other things, is addressing a possible gap identified by National Defence related to federal and provincial air emission regulations.

12.288 The Department has monitored effluent at some bases through base-level funding or through a headquarters-based program, the Corporate Environmental Program (CEP). The testing that was conducted touches on some of our concerns and other monitoring programs that the Department is addressing.

12.289 The CEP, which funds a variety of environmental projects, will cease to exist at the end of the 2002–03 fiscal year. When this occurs, environmental projects and programs will be at risk of not succeeding unless they are appropriately funded through some other means. In an effort to help address this problem, the Department is conducting a study to evaluate future environmental risks and liabilities. It will then be able to develop strategies to mitigate or eliminate these risks and liabilities.

Compliance management remains weak

12.290 Our audit found widespread, frequent, and recurring instances of non-compliance with legal and policy requirements, and a lack of information on overall compliance with those requirements. In addition, the management systems to ensure compliance at the base and unit levels did not promote continual improvement. We recommended that the Department have consistent audit and inspection programs at headquarters, and consistent methodology for annual audits at the base level. We further recommended that bases and units establish performance measures for hazardous materials compliance that measure continual improvement toward a target of full compliance.

12.291 The Department has drafted a national-level environmental management system (EMS) based on the ISO 14001 environmental management system standard. The EMS contains principles that commit National Defence to continual improvement and to compliance with relevant legislation and regulations and with other requirements to which the department subscribes. The EMS also commits the Department to developing audit protocols and conducting audits on a three-year cycle at the command level.

12.292 The national level EMS serves as a guide for command-level environmental management systems, which in turn serves as a guide for base-level systems. The target date for the development and implementation of the first full cycle of environmental management systems across the Department is not until March 2004.

12.293 Core requirements for audits and inspections were not yet developed or included in the national-level EMS. Consequently, command-level and base-level audit and inspection protocols have not become standardized for comprehensiveness and consistency. Some officials noted that a key component of the audit and inspection process must include third party audits, whereby the audit team is made up of personnel from outside the group being audited. Third party audit results are considered less biased and more objective.

12.294 As part of the EMS process, organizations must identify their legal and other requirements. The Department's environmental policy, the Code of Environmental Stewardship, commits the Department to meeting and exceeding the letter and spirit of all federal environmental laws and, where appropriate, being compatible with municipal, provincial, territorial, and international standards. Our audit noted that National Defence did not define the term "where appropriate." Consequently, it was not clear in what circumstances the Department's actions would be compatible with municipal, provincial, territorial, and international standards.

12.295 The Department has only recently initiated efforts to develop and issue a policy that clarifies federal, provincial, and municipal regulations, and standards applicable to departmental activities on federal lands. The final policy is expected in the spring of 2002.

12.296 Although progress is slow in addressing our recommendations, the Department intends to establish a departmental definition of full compliance. This will provide the needed guidance to subordinate environmental management systems on the extent to which bases and wings are to meet provincial, municipal, and other requirements applicable in their jurisdictions.

Revenue Canada—Goods and Services Tax: Returns Processing and Audit (1999, Chapter 16)

Assistant Auditor General: Shahid Minto
Principal: Jamie Hood

Background

12.297 The Goods and Services Tax (GST) is a multi-stage sales tax levied on taxable goods and services. The GST applies on each exchange of taxable goods and services, from the initial producer or supplier through intermediate producer or supplier to consumers. To ensure that the value added at each stage of the supply chain is taxed only once, producers and suppliers are able to recover the GST paid on their purchases of business inputs through "input tax credits." The Harmonized Sales Tax (HST) is collected in three of the Atlantic provinces and is an integral part of the GST program. The objective of the 1999 audit was to assess the efficiency and effectiveness of Revenue Canada's GST returns processing and audit activities.

12.298 In 1999 we noted that Revenue Canada, now the Canada Customs and Revenue Agency (CCRA), had streamlined its GST processing operations at its Summerside Tax Centre and improved their timeliness. However, we were concerned that the standards for processing returns did not place enough emphasis on quality, accuracy, timeliness, and unit cost. Furthermore, we noted that better performance measures would help to manage interest costs and improve the service to registrants. At the time of our audit, these operations were being redistributed among other processing centres and we were concerned that efficiency gains could be lost.

12.299 We also noted that the automated procedures used to identify higher-risk GST refund requests for pre-payment review needed to be more discriminating. We recommended that Revenue Canada review its preliminary processing procedures and consider reviewing those returns that included payments. We also found that GST post-payment audits could be better planned and executed, that they took too long to complete, that audit staff were not adequately trained, and that performance could be improved with a better selection of registrants for audit. Despite the enhancements made to various systems, we were concerned about the accuracy of the analyses done to evaluate the pre- and post-payment audit processes.

Focus of the follow-up

12.300 Our follow-up consisted of reviewing the status report prepared by the Canada Customs and Revenue Agency on its progress to implement our 1999 recommendations, reviewing supporting documentation, and holding discussions with its officials.

Conclusion

12.301 The Agency has made satisfactory progress in addressing all of our recommendations, except in the GST audit program support area where much of the effort to completely address our recommendation lies in the future.

Observations

12.302 The processing of GST return and rebate claims consists of opening and sorting the mail, validating the claims for completeness, batching them by type of document, entering the relevant document information into a central processing system, and correcting errors. If the total GST charged by a registrant to its customers exceeds the input tax credits claimed, the registrant is expected to remit the difference to the Agency. This is known as a "debit return." If the input tax credits exceed the GST charged, the registrant can claim a refund from the Agency. This is called a "credit return." CCRA pays interest on claims that take more than 21 days to process. The Agency also receives claims for rebates of GST paid from, for example, visitors to Canada.

12.303 A number of automated validity checks are applied to GST credit returns and rebate claims to detect those that may not comply with legislation or that may warrant investigation for some other reason. Selected returns are electronically forwarded to local Tax Services Offices (TSOs). As part of the pre-payment audit process, an officer examines each item and decides whether to pay the amount claimed or to refer the claim to an auditor who conducts a more in-depth examination.

12.304 The Agency also does post-payment audits to find other kinds of non-compliance with the many requirements of the *Excise Tax Act*, and to find problems with refunds that have already been paid. Using computerized support systems, auditors in TSOs select, plan, and do GST audits that represent a high risk of non-compliance. Results of audits are reported in Agency systems.

Progress made in processing GST returns

12.305 In 1999 we were concerned that management was not taking full advantage of available information and that Revenue Canada had not updated its processing standards to include quality, accuracy, timeliness, and unit cost. We were also concerned that it had not done benchmarking activities with other large processing centres of other similar organizations to assess its performance standards, its service delivery options, and its technologies.

12.306 In the follow-up, we found that the Agency has taken steps to monitor its returns processing activities and has developed reports on its data capture and error correction activities. It also compares the efficiency and quality of those activities among Tax Centres. Standards have been established for the new GST Telefile service. Managers recognized the need for official performance indicators related to other aspects of processing such as unit cost, but these have not been developed yet. Processing activities have been benchmarked to compare efficiencies among Tax Centres, but benchmarking has not yet been broadened to include other similar organizations.

12.307 We were also concerned in 1999 that Revenue Canada was not monitoring and controlling the amount of its portion of interest charges. The amount of interest cost that has been avoided could be a valid performance indicator of processing efficiency and service to registrants.

12.308 During the follow-up, we found that the Agency has directed its managers to pay particular attention to transactions that need to be corrected and to process, as a priority, those credit returns that stand to earn interest. The Agency is promoting the Direct Deposit of refunds to reduce the time it takes for a payment to reach a registrant. The Telefile option that was introduced in April 2001 to enhance service to registrants was also put in place to reduce interest costs. The Agency is developing a new report that will differentiate between interest amounts due to slow processing and those paid as a result of audit activities. When completed, this report is expected to provide managers with the necessary information to help them monitor and control the amount of interest that they are responsible for.

Progress made in GST pre-payment audit program; debit returns continue to be examined in post-payment audit

12.309 In our 1999 audit, we were concerned about several aspects of Revenue Canada's pre-payment audit programs:

- Automated validity checks were inefficient because they were not particularly discriminating, and many returns chosen by the checks did not need to be reviewed.
- Debit returns were not being considered as part of the pre-payment audit process.
- Procedures in TSOs to allocate resources and manage the review and audit of refund claims were out of date.

12.310 In the follow-up, we found the following:

- The Agency has reviewed and revised its automated validity checks for credit returns. More changes for credit return validity checks are to be implemented in 2003 and 2004.
- The Agency is currently analyzing validity checks for rebates and changes should be implemented in phases between 2003 and 2005.
- The Agency has considered reviewing and auditing debit returns at the same time as it conducts pre-payment audits of credit returns. It has concluded that its audit selection procedures for post-payment audits are appropriate to select high-risk debit returns. These selection procedures are reviewed periodically.
- The Agency has established a new model for allocating resources to the audit program. The model identifies GST pre-payment audits as a program priority. New guidelines for managing GST pre-payment audits that require establishing dedicated GST/HST audit teams have been drafted and were being released at the completion of the follow-up.

Agency improved its GST post-payment audit

12.311 In 1999 we were concerned that Revenue Canada needed to continue to improve its audit selection systems and provide additional training to those people that use them to select post-payment audits. It also needed to enhance its efforts to reduce the duration of audits.

12.312 Our follow-up work revealed that the Agency had recently revised its Workload Development Guide to assist staff in the use of audit selection systems. The Agency was also working with Statistics Canada to improve standard industry classification codes to reflect more detailed and accurate descriptions of the major business activity. The GST/HST Enhanced Registration Review pilot project was initiated to improve the criteria used to identify potentially high-risk registrants early on in the process. The results of the project will be reviewed to ensure that the criteria are acceptable to all regions.

12.313 We also found that the Agency had reduced team sizes and had put in place specific accountabilities for TSOs to report every six months on their progress in meeting audit objectives. This report includes status reports on audits outstanding for more than six months. A focus group was also held and it made recommendations that were implemented in field offices. These included recommendations for better-defined goals and objectives, more auditor accountability, more attention to file selection, and auditor training matched to audit responsibilities. A pamphlet informing taxpayers and registrants of their responsibilities during audits was distributed to help reduce the time taken to complete them.

Change in approach to support GST audit programs

12.314 In 1999 we were concerned that timely information was not available to effectively manage the pre-payment and post-payment audit programs. It was hard to determine which activities were working well and which ones needed improvement. It was also difficult to analyze variances in audit projects.

12.315 We found that the Agency had abandoned the "power play cubes" prototype it was hoping to use to track audits as a replacement to the 1999 systems. More recently, the older reporting systems have been enhanced to include more pre- and post-payment audits. In addition, several ad hoc reports are generated by the Agency to aid in managing the credit return workload. Although Agency management thinks that the current reports are adequate for decision making, the Agency is designing a replacement reporting facility to be implemented in 2001–02. The Agency also plans to implement report card monitoring in 2001–02 to improve the reporting of actual performance results against plan. Progress has been achieved, but much of the effort to completely address our recommendation lies in the future.

Preparedness for Year 2000: Final Preparation (1999, Chapter 25)

Assistant Auditor General: Doug Timmins
Principal: Nancy Cheng

Background

12.316 In the late 1990s, public and private sectors around the world were preoccupied with the threat posed by the Year 2000 computer problem. The Year 2000 problem refers to the potential for system errors, malfunction, or failure caused by the past practice of representing the year with a two-digit code.

12.317 Our third audit on Year 2000—reported in 1999, Chapter 25—examined the progress the government was making in its final preparations. The audit focussed on seven mission-critical functions and the results of remediation and testing at six organizations responsible for them. We also examined several horizontal issues, such as the government's communication strategy and departmental contingency planning. We commented on the significant progress made by the government and offered recommendations for action to be taken beyond December 1999.

Focus of the follow-up

12.318 Our 2001 follow-up work consisted primarily of interviews with staff at the Treasury Board Secretariat and a review of documents at the Secretariat relating to Year 2000. In addition to reports of the Secretariat's Year 2000 project office, we also reviewed project completion reports for the six departments and agencies responsible for the seven mission-critical functions that we audited in 1999.

Conclusion

12.319 The follow-up showed that significant efforts were made in the period leading up to and beyond the millennium rollover to avoid system problems in 2000. Further, the government has taken steps to document lessons learned from preparing for this government-wide threat. However, limited progress has been made to ensure that departments and agencies are aware of and in compliance with government date standards, and measures to address this issue have yet to be developed and implemented. With respect to valuable information bases, steps are being taken to require departments and agencies to update and maintain them; the policies, standards, and practices are not expected to be finalized until 2003.

Observations

12.320 After 1 January 2000, the Treasury Board Secretariat led various projects to capture lessons learned from Year 2000. Some of the more significant projects are as follows:

- Departmental Project Completion reports were written and/or updated in winter 2000. Most of the six organizations that we audited in 1999 indicated to the Secretariat that they plan to maintain critical systems inventories and/or business continuity plans.

- Final business readiness interviews were conducted in spring 2000 with departments and agencies responsible for government-wide mission-critical functions. These interviews dealt with issues such as Year 2000 incident reports, project completion, harvesting benefits, the total incremental cost of Year 2000 remediation and related activities, lessons learned, and adherence to the date standards.
- A Post Implementation Assessment Report was completed in July 2000. Its purpose was to assess the management of government operations for Year 2000 issues, and it included an appendix on lessons learned.
- A Year 2000 Learning Model identifying key elements for the successful implementation of a large-scale horizontal initiative was prepared. Presentations were made to departments and agencies in fall 2000.

Government date standards

12.321 In 1999 we recommended that the Treasury Board Secretariat ensure that all departments and agencies be made aware of the existing government date standards and that departmental plans be put in place to comply with the date standards in future upgrades and maintenance of departmental systems. Standardized coding for dates provides better efficiency in data exchange between government agencies or with non-government organizations. Furthermore, the use of a four-digit year code, as required in the date standards, alleviates the need for updating and maintaining date codes that involve only two digits. Many departments and agencies used the "windowing technique" and retained a two-digit year code in their Year 2000 remediation strategy.

12.322 Government date standards have been adopted since 1988 and form part of the Treasury Board Information Technology (TBIT) Standards program. During the follow-up, we noted that there had been limited activities in recent years to update, disseminate, and monitor the use of those date standards. The Secretariat advised us that a standards manager is now in place to revise the TBIT standards to prepare for Government On-Line, a government-wide initiative to put major government programs and services on-line. The Secretariat indicated that the revised TBIT standards will include date standards with a four-digit year code.

Maintenance of Year 2000 information bases

12.323 The Year 2000 computer problem provided departments and agencies with an opportunity to better understand their critical information systems and to properly document them. Contingency planning also became a key activity in preparing for Year 2000. In 1999 we recommended that the Treasury Board Secretariat consider requiring departments and agencies to maintain and update valuable information bases that were developed to respond to Year 2000.

12.324 The Treasury Board Secretariat advised us that the Government Security Policy was under revision and that information technology security will form a key part of the new policy. In reviewing the draft documents, we noted that departments and agencies will be required to plan for business continuity. According to the Secretariat, departments and agencies will need to review their mission-critical functions and update the list of related systems as part of that planning. The Treasury Board Secretariat expects standards pursuant to the Government Security Policy to be finalized in 2003.

12.325 In preparing for Year 2000, the National Contingency Planning Group identified and defined elements of Canada's critical infrastructure. This information now rests with the Office of Critical Infrastructure Protection and Emergency Preparedness (OCIPEP), an agency created in February 2001 to develop and implement a comprehensive approach for protecting Canada's critical infrastructure.

Vigilance over potential Year 2000 pitfalls

12.326 In 1999 we noted the possibility of Year 2000 causing problems with systems and operations beyond the rollover date of 1 January 2000. We recommended that the government remain vigilant beyond 1 January 2000 to guard against potential Year 2000 pitfalls.

12.327 The government responded by keeping the Treasury Board Secretariat Year 2000 project office open until 31 March 2000. A post-Year 2000 office remained in place until 1 December 2000. The departments and agencies were made aware of all potentially sensitive dates in 2000, and measures were in place to address any potential incidents. According to the Secretariat, no incidents have been reported.

National Defence—The Proper Conduct of Public Business (1999, Chapter 26)

Assistant Auditor General: David Rattray
Principal: Peter Kasurak

Background

12.328 During the 1990s National Defence suffered from several highly publicized breakdowns in management and leadership conduct. Our Office received serious complaints of abuse of resources by Defence staff. Therefore, we undertook an audit of the Department's support of ethical conduct; its maintenance of effective internal controls, including internal audit; and its follow-up on complaints.

12.329 We identified findings that were not significant enough to bring to the attention of Parliament but that warranted action by the Department. In January 2000, we reported these matters in a management letter addressed to the Deputy Minister.

12.330 In our 1999 audit we reported that, in response to a growing need to re-emphasize ethical decision making and integrity, the Department had developed a Defence Ethics Program. Overall, we found that the Department had been slow in carrying out the Program. We concluded that, unless more leadership was shown from the top, it was unlikely that a uniform approach would emerge and be carried out consistently throughout the Department and the Canadian Forces.

12.331 We also found weaknesses in departmental control systems, including internal controls, internal audit, and the military police. Audit resources assigned to the military services had declined and systematic risk analysis was not used to apply the remaining resources to the highest priorities. Managers had become concerned that the risks they were taking were too high. Local management was concerned about weaknesses in financial management systems. Departmental audits revealed an increasing risk of fraud and abuse. A case of widespread systematic abuse—secret commissions and kickbacks for diesel fuel purchases—had escaped detection.

12.332 We examined how the Department responded to complaints directed to senior management at National Defence Headquarters. We found that allegations of abuse had not always been dealt with adequately. Corrective action had been inconsistent and remedial action was slow. We recommended that the Department track all complaints and ensure that they be resolved expeditiously.

12.333 Findings reported in our management letter showed lapses in monitoring and control by the Department and the Canadian Forces. The management letter addressed values and ethics programs, environmental allowances, and provision of official residences, furniture, and hospitality and entertainment. The principal findings were the following:

- Errors were detected in reporting on the progress of the implementation of the *Statement of Defence Ethics* to the Minister's Monitoring Committee.
- Inconsistencies were noted in the use of official residences by senior military officials, including inadequate requirement for some residences, occupancy by staff other than those justified in the original requirement, questionable requirements based on representational duties that could be performed at other military facilities, and inadequate justification for rent reductions.
- High maintenance costs and lack of maintenance standards were found for official residences at Norfolk, Virginia and Colorado Springs, Colorado.
- Hospitality expenditures were inconsistent with Treasury Board policy on such events as holiday parties and levees.
- Pay for hazardous duty or adverse environmental conditions was awarded to staff that were not eligible for it.

Focus of the follow-up

12.334 We followed up on the chapter recommendations and those made in the management letter. We reviewed official documentation and interviewed departmental officials on the related issues.

Conclusion

12.335 The Department has made progress in carrying out the chapter's recommendations. However, the Defence Ethics Program—a key response to ethical problems—has still not been fully implemented seven years after it was launched by senior officials in 1994. Little progress has been made in carrying out the recommendations addressed to the Deputy Minister in the management letter.

Observations

Implementation of Defence Ethics Program by headquarters groups remains slow

12.336 Our 1999 audit recommended that the Department implement the Defence Ethics Program as quickly as possible. We found that progress continues to be slow. The development of the Defence Ethics Handbook has been completed and a final version has been distributed electronically throughout the Department. A formal Defence Ethics policy was promulgated only in June 2001. However, program implementation remains a concern. Two years after the tabling of our chapter to Parliament, only 3 of the 13 National Defence headquarters groups reviewed have developed acceptable plans to carry out the Ethics Program. Officials told us that they intend to rewrite these plans by November 2001.

12.337 In 1999 we found that 4 of 10 headquarters group ethics co-ordinators were reporting to middle rather than senior management and that 3 of 10 were at a more junior rank than recommended by the Ethics Program. Our follow-up found that National Defence has in many cases separated the co-ordinator role into two jobs: Ethics Advisory Board member and ethics co-ordinator. Although most Ethics Advisory Board members are at a senior level, in 7 of 13 cases the co-ordinator is still relatively junior in rank. Several co-ordinators also told us they did not have direct access to the most senior manager of their group. We are concerned that inconsistencies in separating the two roles could weaken the position of ethics co-ordinator.

12.338 The Chief Review Services has not produced program performance reporting instructions for departmental business plans. Departmental officials are attempting to develop a tool to assess the effectiveness of program implementation to complement the Baseline Survey model already in use. Development of the tool has proven to be more difficult than expected as few organizations have attempted to measure the progress made by value-based ethics programs. Nevertheless, officials anticipate completion by 2002.

12.339 The Defence Ethics Program is being slowly integrated into formal human resource management systems. We found that the Canadian Forces Personnel Appraisal System presently incorporates an assessment factor titled "Ethics and Values" for colonels and general officers. The new appraisal system for non-commissioned members and officers up to lieutenant-colonel still does not include ethics as a specific element. Officials told us that ethics would be included in the next version of the appraisal to be implemented in 2002.

12.340 The Department has undertaken additional initiatives on defence ethics. A baseline survey conducted in 1999 found that fairness was a significant issue in the Department. Discussions by National Defence staff on addressing this issue in parallel with Quality of Life activities are under way. The Department has established an ethics newsgroup and chat room to provide a forum for all staff to discuss ethical issues. It has also held a Department-wide ethics week to focus on dialogue and solicit feedback and comment on issues of concern.

Steps have been taken to address risk

12.341 The environment in which National Defence operated in 1999 was rapidly changing, and it was essential that the Department identify, manage, and control risk. We therefore recommended that risk assessments be conducted and audit resources assigned commensurate with the risks identified. We also recommended that the audits by the Chief Review Services Branch and those by the three armed services be co-ordinated. The Chief Review Services has developed a comprehensive risk assessment in its 2000–01 plan in co-operation with headquarters groups and the three services. The Branch has also launched a major audit of the management and control of local funds to increase audit presence in the field and has developed a fraud risk management strategy. The Audit and Evaluation Committee has tasked the Chief Review Services to develop direction to co-ordinate audit work of the Branch and the three services.

A strategy is being developed to address fraud and abuse of resources

12.342 Management cannot rely solely on internal audit as a control. Audit only validates the effectiveness of other controls. Our 1999 audit recommended that the Department reinstate its management checks of compliance, consistent with assessed risk, to reduce the likelihood of fraud and abuse of resources.

12.343 The Department has implemented an initiative to revitalize finance, including clarification of comptrollers' roles and responsibilities. The goal is to ensure that there are sound financial management controls and management practices at all levels of the organization. Financial policies and procedures are being developed or updated. The Department has a strategy to communicate new policies and procedures to financial administrators before they are issued and intends to follow up on their application. There is also an increased focus on training related to financial policy and the new financial information systems as well as on the development of reference material. Commands and groups have also increased their local training efforts in the areas of contracting, verification of accounts payable, and the use of acquisitions cards.

Military Police independence has improved

12.344 In response to our audit, the Department has done a great deal of work to strengthen the training of commanders to ensure the independence of the Military Police. Presiding officers are now trained and certified as qualified to perform their duties in the administration of the Code of Service Discipline. Military Police reform is being adopted. The Military Police Professional Code of Conduct and the Occupational Structure Implementation Plan (OSIP) will ensure that the highest professional standards are maintained in the Military Police Branch. The Department expects that the implementation of the OSIP will commence by September 2001.

12.345 Other recommendations and observations from the report of the Military Police Services Review Group have been carried out except for the implementation of a new Security and Military Police Information System. The first phase of this project is under way and is scheduled to be completed in early 2002. The second phase is expected to be in place by September 2003.

Department takes action on complaints more quickly

12.346 In 1999 we reviewed complaints received by our Office and referred to the Department since 1995. We also reviewed complaints that the Deputy Minister and the Chief of the Defence Staff had assigned to the Directorate of Special Examinations and Inquiries since its inception in 1992. Some complaints took two to three years to investigate. We recommended that the Department ensure that all complaints be followed up promptly and tracked, with the objective of completing them in a year.

12.347 We followed up cases begun after the completion of our audit to the end of June 2001. We found that the Chief Review Services had reduced the time taken to follow up on complaints. Staff completed 16 cases within four months on average. Another 16 cases are still open but only four have been open for more than a year. Two cases have been transferred to other agencies for further investigation.

12.348 The Chief Review Services developed various tools to ensure that proper follow-ups are carried out. Requests for special investigations are now tracked from start-up to closure, and it is now easier to verify the state of the file. A guide for the conduct of special examinations and inquiries has also been developed to provide guidance to staff.

12.349 We also recommended that the Chief Review Services follow up on corrective and remedial action and report the findings to the Deputy Minister. We found that when cases are closed, special investigation staff prepare a checklist that must be signed off by both their Director and the Chief Review Services. This checklist includes recommendations on whether follow-up action will be required.

Action on recommendations in our management letter is incomplete

12.350 Our management letter addressed to the Deputy Minister made recommendations on the use of public funds and on ethical issues.

12.351 We recommended that the Department clarify the interpretation of the hospitality policy with the Treasury Board Secretariat. We also recommended that the Department develop clear policy and ensure compliance with the intent of hospitality and entertainment policies and regulations. The Deputy Minister and the Chief of the Defence Staff have issued direction on hospitality, especially that offered inside Canada. Officials are working with the Treasury Board Secretariat and other departments to update hospitality policy for outside Canada.

12.352 In regard to our concerns about the inadequate management of official residences, staff have developed a draft policy for consideration by senior management in October 2001. The policy, if adopted, would be a good step forward. However, significant concerns about the draft policy remain. Criteria for the identification of requirements for residences appear vague and the rationale supporting the proposed retention of some residences rather than others is unclear. In addition, the Department may allow commanding officers to continue to pay for improvements and maintenance in excess of standards from their base operating budgets. We note that the Department estimates that official residences have cost much more than other base housing to maintain. An accountability structure is required that separates decision-making and expenditure authority from potential occupants of official residences.

12.353 We recommended that a central program authority be appointed for environmental allowances to clarify accountability and the lack of record keeping. An Allowance Review Project was established in January 2001 and the new policy is planned to be completed in the fall of 2002.

12.354 We also observed errors in reports to the Minister arising from staff mixing up the Canadian Forces Ethos Statement and the Defence Ethics Statement. However, the Department has taken steps to clarify the two statements and is working to integrate them further. Officials told us that progress reports are now accurate. The Canadian Forces are continuing to develop a complete concept of military ethos as part of their professional development initiatives for officers and non-commissioned members.

National Defence—Alternative Service Delivery (1999, Chapter 27)

Assistant Auditor General: David Rattray
Principal: Peter Kasurak

Background

12.355 In 1999 we audited the Alternative Service Delivery (ASD) program at National Defence; the program seeks to provide new and better ways of providing government services. Our audit objective was to determine how well National Defence was managing its ASD program and how well it had progressed toward ensuring that non-core support services were delivered to core defence activities in the most cost-effective way. We focussed on the strategic framework, the analytical framework (business case analysis), human resource management, and the contracting aspects of the program. We audited 14 completed projects initiated between 1994 and 1996.

12.356 The Department had not achieved the savings it expected. It had reduced its annual savings projections from $200 million by 1999 to $175 million by 2004. Many of the business case analyses for the 14 projects were poorly done, and personnel appeared to lack the necessary skills to undertake analyses. In addition, the government lacked an adequate framework for "partnering" with the private sector and contracting out large service programs. Further, inflexible contract arrangements in two cases resulted in payments for unused training capacity.

12.357 The Standing Committee on Public Accounts held hearings on our Report and made recommendations on improving business case analysis and developing the necessary skills and training to manage the ASD program, including the application of its management framework. The Committee recommended the development of a culture that favours an awareness of costs and a more businesslike approach. It further recommended that the Department include its ASD plans and savings targets in its annual *Report on Plans and Priorities* beginning in 2001–02, and that it report progress in its *Performance Report* beginning with the period ending 31 March 2002. Finally, the Committee recommended that the Department resolve with the Treasury Board Secretariat any remaining substantive issues related to implementation of the Financial Information Strategy and that it use the financial data to guide its ASD program.

Focus of the follow-up

12.358 We followed up on our recommendations and those made by the Public Accounts Committee. We also interviewed the National Defence Headquarters managers responsible for the ASD program, reviewed documentation, and communicated with both the Treasury Board Secretariat and Public Works and Government Services Canada. In addition, we reviewed a consultant's project report entitled the *ASD Capacity Check* (May 2001). The Department had initiated this project to assess the capabilities needed to deliver ASD within National Defence, to properly situate ASD within a strategic change perspective, and to ensure that ASD is clearly oriented to optimizing combat capability.

12.359 We did not review the two ASD projects begun since our original audit. Nor did we review the NATO Flying Training in Canada project, because of the ongoing implementation process.

Conclusion

12.360 The Alternative Service Delivery program will no longer be identified as a separate program. Essentially the Department intends to integrate ASD into a new program of continuous improvement. This is in part due to the negative view of ASD held by many managers and staff, the increased emphasis on performance measurement, and the need to apply continuous improvement to all departmental activities. This program will continue to emphasize the goal of developing efficient and effective programs and services. The Department has taken some action on almost all of our recommendations.

12.361 We were unable to assess our recommendation directed to the Treasury Board Secretariat. The Secretariat has yet to complete its work on the provision of guidance and training for large multi-year service contracts, including the key issues of how competition is to be addressed in situations where long-term "partnering" would be beneficial to the government.

Observations

ASD program stalls

12.362 Since we completed our original audit, only two new ASD projects have been introduced. Our interviews and the *ASD Capacity Check* suggest several reasons for this. The *Capacity Check* indicates that managers are neither committed to nor supportive of the ASD program because they feel the process is too burdensome. They are apt to avoid the process altogether. These negative views probably developed because of the threat of job loss brought on by the program's strong initial focus on cost savings and contracting out. Officials informed us that there are numerous "ASD-like" activities occurring throughout the Department, but managers simply do not want to become engaged in the full ASD process. Senior management now realizes that initial expectations were too high, the time frame for change was underestimated, and promised savings have not materialized.

ASD to be part of broader continuous improvement program

12.363 National Defence is changing its approach to ASD. The Department intends to integrate the program within its continuous improvement strategy, and ASD will no longer be identified as a separate program. Continuous improvement will apply to all activities and eventually will include the identification of service levels and costs of all services. It will also include an increased emphasis on performance measures and costs and on the success of managers in reaching pre-agreed targets. As in the ASD program, business case analysis and many of the techniques for determining the most efficient and effective way of delivering services will remain applicable. The Framework for Strategic Change within which to pursue ASD initiatives was approved by senior management in June 2001.

12.364 Although the ASD program will soon cease to exist in the form we originally audited, many of our recommendations and those of the Public Accounts Committee remain relevant. The Department's actions toward implementing these recommendations are assessed in the following paragraphs.

ASD training is now available

12.365 Both the Public Accounts Committee and the Auditor General recommended that training be provided for people responsible for evaluating and implementing ASD projects, particularly those skills associated with business case analysis.

12.366 The Canadian Forces Management Development School has developed new training modules on ASD methodology, business case analysis, and various other ASD topics. In addition, the chapter on business case analysis in the Department's costing handbook has been revised and a best practice publication on business case analysis is planned. As well, a Base Service Index is being developed that will provide standards for base services and will eventually be used to establish costs and set priorities for resource allocation.

Human resource policy established for employees affected by ASD

12.367 The Department has developed and issued a national policy on employment continuity that is to be applied to all ASD initiatives affecting 10 or more permanent employees. This policy was developed to ensure that all National Defence employees affected by ASD are treated in a fair and reasonable manner. The national policy addresses the weaknesses and inconsistencies of the case-by-case approaches used in earlier ASD initiatives.

No reference to ASD in Report on Plans and Priorities

12.368 Despite a Public Accounts Committee recommendation, the Department did not provide details in its 2001–02 annual *Report on Plans and Priorities* on the human, financial, and technical resources it is devoting to implementing its ASD program. Although the Department accepted the recommendation in principle, it states that ASD is to be considered part of the Department's overall continuous improvement plan. However, the Department does commit itself to reporting annually in its *Performance Report* on overall progress and lessons learned and applied from initiatives.

Departmental cultural change a work-in-progress

12.369 The Public Accounts Committee recommended that National Defence, under the leadership of the Deputy Minister, assign immediate priority to developing a departmental culture that favours an awareness of costs and a more businesslike approach. The Department accepted this recommendation in full and stated that it had given priority to four projects that underlie the Department's move to a more businesslike culture. Collectively these four projects are referred to as the Modern Management

Agenda. The Modern Management Agenda is under the direct control of the Deputy Minister and includes the integration of management systems, the improved development and use of financial information, human resource management, and the integration of enterprise information systems.

12.370 The Department has also established an implementation plan addressing various elements of continuous improvement. This implementation plan includes the introduction of businesslike tools such as standards and performance measurement and an increased emphasis on business case analyses.

Work on procurement reform fails to address concerns about "partnering"

12.371 The Auditor General recommended that the Treasury Board Secretariat develop guidelines and training for large multi-year service contracts. We further recommended that such guidelines and training address the key issues of how competition is to be addressed in situations where long-term "partnering" would be beneficial to the government.

12.372 The Treasury Board Secretariat informed us that it is working with Public Works and Government Services Canada and National Defence on a Framework and Best Practices Guide on Long-Term Complex Contracts. As this guide has yet to be completed, we were unable to assess whether this recommendation has been addressed. These contracts must be implemented consistent with the Government Contracts Regulations and the government's contracting policy. Nevertheless we believe that guidelines and training for large multi-year service contracts addressing the issue of competition within a "partnering" context would be beneficial.

12.373 Public Works and Government Services Canada deals with the need for training related to multi-year contracts through its Benefits Driven Procurement program. However, the Department told us that Benefits Driven Procurement training does not address specifically how competition is to be addressed in situations where long-term "partnering" would be beneficial to the government. The Department's view is that it deals with competition in many ways, and its policy and procedural environment, supported by training, is applicable to all procurement strategies, not just Benefits Driven Procurement.

Department of Foreign Affairs and International Trade—Delivery of Capital Projects in Four Missions (1999, Chapter 31)

Assistant Auditor General: Shahid Minto
Principal: John Hitchinson

Background

12.374 In 1999 we noted that the number of increases in preliminary cost estimates and other problems identified by our audit seemed to indicate systemic weaknesses in the Department's planning of capital projects. We observed a lack of rigour in the Department's analysis of options in support of its recommendations to the Treasury Board. We also noted two instances where the Department had exceeded its delegated authority and Treasury Board approval was granted retroactively. We stated that the quality of reporting to the Treasury Board to explain project delays and budget increases needed to be improved.

Focus of the follow-up

12.375 Our follow-up consisted of a review of actions taken by the Department of Foreign Affairs and International Trade in response to our recommendations. It involved enquiry, discussion, and a review of various documents supplied by the Department to the end of August 2001.

Conclusion

12.376 The Department has taken action on all of our recommendations. In March 2001, the Deputy Minister submitted to the Treasury Board Secretariat a comprehensive report on steps being taken to improve the management of property in the Department. The Management Improvement Plan for the property program covers a wide range of issues, including those raised in our Report.

12.377 The Department has improved its planning capacity for capital projects and strengthened its guidelines for the planning of projects. By maintaining a sustained effort to implement the Management Improvement Plan as well as the revised guidelines, the Department can make real progress toward improving its property management.

Observations

Information to Treasury Board and use of authorities

12.378 Subsequent to our audit, the Physical Resources Bureau at the Department submitted an action plan to the Treasury Board Secretariat. The plan aimed at strengthening the rigour of the estimates of cost and the scope for preliminary project approval. The Bureau began revising project management procedures and incorporating risk management plans into Treasury Board submissions. The Bureau staff is also working with the Secretariat to produce a new Property Business Plan.

12.379 In correspondence with the Department, the Treasury Board Secretariat underlined the importance of submitting reliable estimates to obtain preliminary approval and remaining within delegated authorities. The

Secretariat clarified that when significant scope changes occur, new approval must be obtained.

Guidelines for assessment of feasibility and definition of feasibility

12.380 Preliminary project approval is based on an assessment of feasibility. In March 2000, the Bureau issued new guidance on preparation of the assessment of feasibility report. The guidance addresses the points raised in our audit, including the need for proper analysis and costing of all reasonable alternatives that could potentially fulfil requirements. At the same time, the Bureau issued guidance on preparation of the definition of feasibility report, which contains the necessary analyses for obtaining effective project approval. The guidance also incorporates best management practices for this phase of the project planning.

12.381 We reviewed a few of the feasibility reports produced after the guidance had been issued. We observed that the Bureau staff had made efforts to follow the guidance but that in some instances required steps had not been completed or not documented.

12.382 **Improvements in costing.** The Bureau has arrangements with a number of qualified consultants to develop the costing of alternatives during the planning phase of a project. It has also provided training to its own staff.

12.383 In order to keep better track of costs during the implementation phase, the Department added a project management module to its management information system. The module captures data on overhead costs and time scheduling, and links the data to the accounting system. The Bureau has begun using this module for all its new projects.

12.384 **Improvements in workflow and project control.** In 2000, the Bureau undertook a broader systematic review of its project delivery processes and procedures. The review began the process toward obtaining ISO 9001 certification in 2002. The Bureau plans to establish and maintain a formal quality control system to ensure that delivered projects meet objectives, satisfy client expectations, and comply with standards. The Bureau is also investigating the possibility of having Public Works and Government Services Canada or other federal government partners take on some project management responsibilities.

Chapter

13

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Other Audit Observations

Main Points

13.1 The *Auditor General Act* requires the Auditor General to include in her Report matters that she considers to be of significance and that should be brought to the attention of the House of Commons.

13.2 This chapter fulfils a special role in the Report. Other chapters normally report on value-for-money audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or audit work to follow up on third-party complaints.

13.3 This chapter covers the following:

- Human Resource Development Canada and the Canada Employment Insurance Commission—Clarity and improved transparency needed to demonstrate compliance with the *Employment Insurance Act* in setting premium rates.
- Department of Finance—Parliamentary oversight weakened in poorly targeted relief for heating expenses.
- Parc Downsview Park Inc.—Parliamentary control of programs and spending.

13.4 Although audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters not examined.

Introduction

13.5 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons in accordance with the *Auditor General Act*. The matters reported were noted during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or our audit work to follow up on third-party complaints. Subsection 7(2) of the *Auditor General Act* sets out the nature of the cases that can be brought to the attention of the House of Commons; this list is not exhaustive, given that any matter of significance can be reported by the Auditor General.

13.6 Each of the matters of significance reported in this chapter was examined in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants. The matters reported should not be used as a basis for drawing conclusions about matters not examined.

Human Resources Development Canada and the Canada Employment Insurance Commission

Clarity and improved transparency needed to demonstrate compliance with the *Employment Insurance Act* in setting premium rates

In brief

The accumulated surplus of the Employment Insurance Account increased by about $8 billion during 2000–01 to $36 billion at 31 March 2001. This is $21 billion more than the $15 billion maximum that the Chief Actuary of Human Resources Development Canada considers sufficient to pay for the higher benefit costs expected during a recession and to prevent premium rates from rising. The Canada Employment Insurance Commission has not provided an adequate justification for the size and the rate of growth of the accumulated surplus. It has not yet decided what constitutes an adequate reserve and how much time is required to reach that level. Therefore, we are unable to conclude that the intent of the *Employment Insurance Act* has been observed in setting the 2001 premium rates. The government plans to review the rate-setting process. In view of the growing size of the accumulated surplus, we urge the government to take all necessary steps to clarify the process and improve its transparency as part of the review.

Background

13.7 The Canada Employment Insurance Commission, co-managed by representatives of the government, workers, and employers, administers the *Employment Insurance Act*. The objective of the Act is to provide short-term financial relief and other assistance to eligible workers. In 1999, 13.6 million people contributed to the Employment Insurance (EI) program and 2.4 million received benefits. Employers and workers pay all program costs through premiums. The EI Account is expected to be self-financing over time.

13.8 Section 66 of the Act requires the Commission to set employment insurance premiums at a rate that it considers will ensure, to the extent possible, enough revenues to cover the program costs and maintain relatively stable rates over the business cycle. The rate set by the Commission must be approved by the Governor in Council on the recommendation of the ministers of Human Resources Development and of Finance.

13.9 Recent amendments to the Act suspended for 2002 and 2003 the rate-setting requirements set out in section 66. The government agreed to undertake a review of the rate-setting process. Meanwhile, the Governor in Council, rather than the Commission, will set premium rates.

13.10 The Auditor General's reports on the financial statements of the Employment Insurance Account and the Government of Canada for the year ended 31 March 2001 expressed continuing concerns about the size and rate of growth of the accumulated surplus. The Account balance increased by about $8 billion during the year, to $36 billion at 31 March 2001.

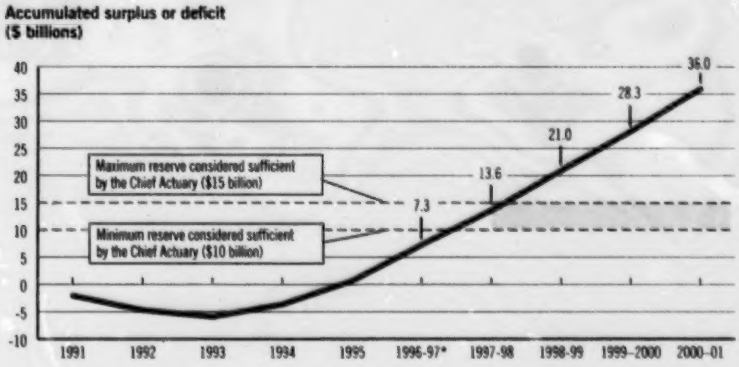
Issues

The Account balance in excess of suggested maximum reserve increased significantly over three years

13.11 The Employment Insurance Account records all financial transactions related to the EI program. The Account balance is the net of the cumulative revenues deposited in the government's Consolidated Revenue Fund and program costs paid out of it. This balance is notional in nature as it is part of the Fund. Benefits and administrative costs are paid out of the Fund and charged to the Account. All amounts received under the Act are deposited in the Fund and credited to the Account. The tracking of the Account balance is important to meet the objectives of the Act—that is, to ensure the fiscal integrity of the Account and the relative stability of premium rates over a business cycle.

13.12 Exhibit 13.1 shows the continuing growth of the accumulated surplus. It rose sharply over five years, from $7.3 billion in March 1997 to $36 billion in March 2001. This represents an annual compounded rate of growth close to 50 percent. The Chief Actuary of Human Resources Development Canada has estimated that a reserve between $10 billion and $15 billion would be sufficient at the beginning of a recession to cover additional program costs, prevent cumulative deficits, and allow stable premium rates over the business cycle. The Account balance in excess of the maximum reserve has grown significantly, from about $6 billion in March 1999 to $21 billion in March 2001. This represents an annual compounded rate of growth of about 90 percent.

Exhibit 13.1 Evolution of the accumulated surplus of the Employment Insurance Account



*For a period of 15 months

Source: Audited financial statements of the Employment Insurance Account

What are the causes of the current high balance?

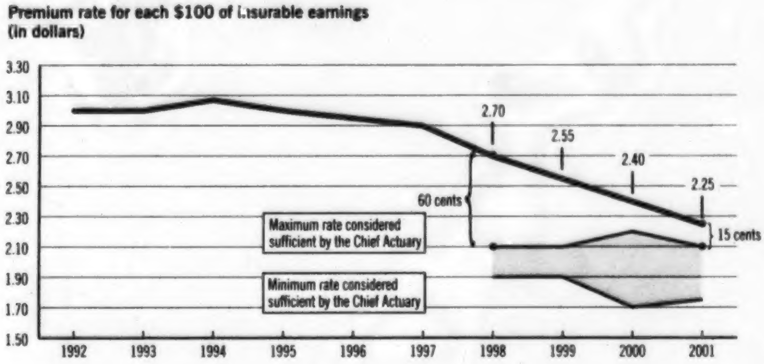
13.13 The Chief Actuary prepares estimates of the desirable amount of reserves needed to pay higher program costs expected during a recession and to prevent premium rates from rising. The Chief Actuary also provides an estimate of a range of possible stable premium rates needed to pay for ongoing program costs over a business cycle, taking into account program changes. The Account balance has continued to grow since 1998 as the premium rate for employees consistently exceeded the upper-limit rate considered sufficient by the Chief Actuary to pay for program costs (Exhibit 13.2).

13.14 The spread between the premium rate and the upper-limit rate has decreased from 60 cents for each $100 of insurable earnings in 1998 to 15 cents in 2001. However, the steady pace of reducing premium rates by 15 cents annually for the last three years illustrates the greater priority placed on maintaining the stability of premium rates than on recovering program costs over a business cycle.

13.15 Interest revenues calculated on the balance of the Account have also contributed to the growth of the accumulated surplus. For example, interest revenues for 2000–01 amounted to $1.6 billion. At 31 March 2001, interest revenues accounted for $3.9 billion of the $36 billion accumulated surplus.

13.16 Interest revenues also have an impact on the setting of premium rates. The Chief Actuary estimated that break-even premium rates are lower at higher reserve levels because of interest credits to the Account. For instance, the Actuary estimated that the 2000–01 interest revenues of $1.6 billion are equivalent to 20 cents of the employee premium rate. This represents close to 10 percent of the premium rate set at $2.25 for 2001.

Exhibit 13.2 Evolution of the Employment Insurance premium rate for employees



Source: Audited financial statements of the Employment Insurance Account and reports of the Chief Actuary of Human Resources Development Canada

The Commission did not provide adequate justification for the size and rate of growth of the Account balance

13.17 In the Auditor General's 1999 and 2000 reports to Parliament, we asked the Commission to clarify and disclose the way it interprets the Act in setting premiums. We found that the Commission had not defined and disclosed to the public and Parliament its interpretation of some key legislative terms related to setting premium rates, such as "business cycle," "enough revenue," and "relatively stable rate levels."

13.18 In December 2000, the Commission set the premium rate for 2001 at $2.25 per $100 of insurable earnings. As the rate is greater than the upper-limit rate of $2.10 that the Chief Actuary considers sufficient to cover program costs, the accumulated surplus is expected to continue growing. The 2001–02 *Report on Plans and Priorities* of Human Resources Development Canada indicates that the Account balance is expected to reach $42.8 billion by 31 March 2002.

13.19 We expected the Commission to clarify and disclose the reasons for collecting $21 billion more than the maximum reserve suggested by the Department's Chief Actuary. The Commission did not explain the reasons for not accepting the Chief Actuary's suggested maximum reserve. Further, it did not provide an adequate justification for the $36 billion accumulated surplus at 31 March 2001. Therefore, we were unable to conclude that the intent of the *Employment Insurance Act* had been observed in setting the 2001 premium rates.

13.20 In our 1994 Study of Key Federal Social Programs, we indicated that a reasonable reserve in the Account would be desirable. At that time, we also raised questions on what constitutes an adequate reserve and how much time is required to build it. The Commission has not yet reached a decision on these two important issues.

13.21 It is the responsibility of the Canada Employment Insurance Commission to provide an adequate justification for the size and rate of growth of the accumulated surplus in the Employment Insurance Account. The Commission did not clarify what constituted an adequate reserve and how much time would be required to reach that level. Without that information, we were not able to conclude whether the intent of the *Employment Insurance Act* was observed in setting 2001 premium rates.

The government plans to review the rate-setting process

13.22 In May 2001, the premium-rate-setting process defined in section 66 of the Act was suspended for 2002 and 2003. The Governor in Council, rather than the Commission, will set the premium rate during that period while the government reviews the rate-setting process. The rationale for suspending section 66 during the review process is unclear.

Conclusion

13.23 It is important that the government clarify whether the objectives of fiscal integrity and relative stability of premium rates over a business cycle remain the guiding principles for determining the premium rates for 2002 and 2003. We also encourage the government to continue consulting key stakeholders, such as employers and workers, as well as the Department's Chief Actuary when establishing the premium rates for 2002 and 2003. Human Resources Development Canada advised us that its Chief Actuary's analysis, prepared annually to support the rate-setting process, has been provided to the EI commissioners to facilitate consultation with stakeholders. To help improve the clarity and transparency of the process, the Chief Actuary's report needs to continue to be made available on demand and to be accessible on the Department's Web site for these two years.

13.24 In reviewing the rate-setting process, the government may want to consider the following questions:

- What constitutes an adequate reserve and how much time is required to reach that level?
- What are the impacts on premium payers and on the purposes and intent of the Employment Insurance program in the short and long terms, where the Account balance exceeds the maximum reserve considered sufficient by the Chief Actuary of Human Resources Development Canada?
- What should be done with an Account balance that exceeds a reserve that the government's review finds adequate?
- What is the rationale for the current method used to calculate interest revenues on the Account balance, and how adequate is it? In the past, we have commented on the lack of rationale for the method of calculating interest on the Account balance.

13.25 In view of the growing size of the accumulated surplus, we urge the government to take all the necessary steps to clarify the rate-setting process and improve its transparency.

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Department of Finance

Parliamentary oversight weakened in poorly targeted relief for heating expenses

In brief

In January 2001, the government provided relief for heating expenses to recipients of the goods and services tax credit (GSTC). The amount of the relief was $125 for individuals or $250 for families. The House of Commons had approved a Notice of Ways and Means motion in October 2000 that included the proposed relief. However, Parliament was dissolved before the necessary legislation to amend the *Income Tax Act* was introduced, debated, and approved. The payments were authorized by an order-in-council, and the funds were provided by special warrants. Furthermore, giving the relief to recipients of the GSTC greatly reduced its effectiveness in achieving the government's objectives. Only about $250 million to $350 million of the over $1.4 billion was paid to low- and modest-income households that faced immediate increases in heating expenses.

Background

13.26 In the October 2000 Economic Statement, the government announced that it wanted to provide some relief for increased heating expenses. It proposed that those eligible to receive the January 2001 payment of the goods and services tax credit would also receive the relief for heating expenses. The amount of the relief would be $125 for individuals or $250 for families. The total estimated cost was $1.345 billion. On 19 October 2000, the House of Commons approved a Notice of Ways and Means motion that included the government's proposal.

13.27 On 22 October 2000, Parliament was dissolved for a general election, which was held on 27 November 2000. Legislation to authorize the relief for heating expenses was not presented to Parliament before it was dissolved.

13.28 On 12 December 2000, the Governor in Council approved an order-in-council to authorize payments for increased heating expenses. The recipients of the payments would be those eligible to receive the January 2001 payment of the goods and services tax credit.

13.29 On 13 December 2000, the Prime Minister announced that Parliament would be recalled on 29 January 2001.

13.30 On 9 January 2001, the Governor in Council directed that a special warrant be prepared to authorize the payment of $1.294 billion for relief for heating expenses. On 23 January 2001, the Governor in Council directed that another special warrant be prepared to authorize the payment of a further $227 million for the same purpose.

13.31 On 31 January 2001, the Canada Customs and Revenue Agency started mailing cheques to about 8.6 million recipients. The total cost of the relief for the year ended 31 March 2001 was $1.459 billion. The payments were charged to the Canada Customs and Revenue Agency's operating expenditures vote and are included in Other Transfer Payments in the *Public Accounts of Canada*.

Issues

Parliamentary oversight of new spending was weakened

13.32 The relief for heating expenses was a new initiative introduced in the October 2000 Economic Statement. Through a Notice of Ways and Means motion, the government proposed to amend the *Income Tax Act* to obtain the authority to make the payments. Such an amendment required Parliament's approval. The House of Commons approved the Notice of Ways and Means motion on 19 October 2000. However, Parliament was dissolved before legislation to amend the *Income Tax Act* was introduced, debated, and approved.

13.33 The government decided that it was important to get the relief into the hands of eligible recipients as quickly as possible during the winter months. To do so, it chose to give the relief in the form of ex gratia payments, authorized by the Governor in Council. No legal obligation exists for an ex gratia payment. Instead, it is made at the government's discretion as an act of benevolence in the public interest. It was necessary to use ex gratia payments because Parliament had not approved any changes to the *Income Tax Act* to cover payments of relief for heating expenses.

13.34 Although the government has the authority to make ex gratia payments, Parliament has to appropriate the funds for them. During Parliament's dissolution, when there is no appropriation for a payment that is urgently needed for the public good, Parliament has authorized the use of special warrants. Therefore, the government received the Governor in Council's approval to issue special warrants in order to provide the funding. The special warrants were reported to Parliament on 12 February 2001.

13.35 We are concerned that parliamentary scrutiny of this initiative was weakened because the government chose an approval process that did not involve Parliament. The government decided that it was important to deliver the relief quickly, and there were few avenues available while Parliament was dissolved.

13.36 We appreciate the importance of delivering the relief quickly to those who urgently needed it. However, the Department knew on 13 December 2000 that Parliament would be recalled on 29 January 2001, two days before the Canada Customs and Revenue Agency began issuing the cheques. In our view, a delay of no more than six weeks would have allowed Parliament the opportunity to debate and approve the spending of public funds before the spending took place, and without compromising the government's objectives.

The relief was poorly targeted

13.37 The relief for heating expenses was provided because the government was concerned about the impact of rising energy prices on home heating costs to low- and modest-income Canadians. However, it did not have information to directly target the low- and modest-income Canadians who were facing increased heating costs.

13.38 The Department considered several options for providing the relief. Most of them were rejected because they would have been costly to administer, or they would have taken too long to deliver the relief, or they would not have been limited to low- and modest-income Canadians. The goods and services tax credit (GSTC) was the only existing mechanism in the tax system that targeted low- and modest-income Canadians. Therefore, the Department concluded that it was the quickest and most cost-efficient mechanism for providing relief to the targeted population.

13.39 The next regular payment of the GSTC after the October 2000 Economic Statement was 12 January 2001. The recipients of that payment would have applied for the GSTC when they filed their 1999 income tax return. The Department of Finance originally hoped to include the relief for heating expenses with the January GSTC cheque, but this was not feasible.

13.40 In our view, while the administrative simplicity of using the GSTC allowed the government to get the cheques out quickly, it greatly reduced the effectiveness of the relief for heating expenses. Overall, there is a weak relationship between those who received the GSTC and those who needed assistance for increases in their heating expenses.

13.41 The Department of Finance ran several simulations, both before and after the payments were made, to determine the effectiveness of the GSTC in providing relief for heating expenses. After analyzing data from the Department and from Statistics Canada, we made several observations:

- Between 15 and 25 percent of the households that received a payment were facing an immediate increase in their heating costs and were considered low- and modest-income households.
- Between 25 and 35 percent of the households that received a payment might have needed assistance in the future. These were low- and modest-income households that did not face immediate increases in their heating costs for one of two reasons: Either they paid rent that included heating costs, and any increase in rent to cover higher heating costs would happen in the future; or they heated with electricity and lived in a province where the price of electricity might increase in the future because of increases in the cost of fuels used to generate the electricity.
- At least 40 percent of the households that received a payment either were not low- or modest-income households or would not likely face higher future heating costs related to the 2000–01 energy market conditions. This included, for example, households that were heated electrically and were located in a province where electricity was mostly generated by hydro power.

13.42 Using reasonable approximations, we estimate that of the more than $1.4 billion paid in relief for heating expenses, the total amount paid to those who faced an immediate increase in their heating costs was between $250 million and $350 million.

13.43 Furthermore, the Department's documents showed that some 600,000 low- and modest-income Canadians did not qualify for the relief because they were not eligible to receive the January 2001 payment of the GSTC, based on their 1999 income. The Department's documents also showed that the cost of extending the relief to these individuals would have been about $75 million. At least 90,000 of these people needed immediate assistance to help with increased heating costs.

13.44 Paying the relief for heating expenses to GSTC recipients also resulted in some anomalies. About one million of the 7.6 million households that received the relief could have received more than one cheque because more than one GSTC recipient lived in the household. At least 4,000 Canadian taxpayers who did not live in Canada and 7,500 deceased people received cheques. While it is difficult to calculate how many prisoners received the relief for heating expenses, based on available data the Department estimates that about 1,600 prisoners could have received cheques. These anomalies occurred because of the rules related to the GSTC. For example, a recipient's income or status could have changed between the time the GSTC was applied for and the time the GSTC was received. The January 2001 payment was one of four installments of the GSTC that recipients applied for when filing their 1999 income tax returns.

Conclusion

13.45 In its haste to provide relief for heating expenses, the government got approval from the Governor in Council and funds were provided by special warrants. Except for a Notice of Ways and Means motion, it did not provide Parliament with an opportunity to approve this spending of public money. Furthermore, our analysis shows that only about $250 million to $350 million of the payments were made to Canadians who faced immediate increases in their heating expenses. At least 90,000 Canadians who needed immediate relief did not qualify for it because they were not eligible to receive the January 2001 payment of the GSTC, based on their 1999 income.

Department's response: The government's objective for this measure was to provide relief from higher heating expenses to those who needed it most, low- and modest-income Canadians, during the peak heating season. The use of the goods and services tax credit (GSTC) to deliver the relief and the legal process that was followed ensured that this was accomplished in a timely manner and with minimum administrative cost.

The relief for heating expenses was announced as part of the government's $100-billion tax reduction package in the October 2000 Economic Statement and Budget Update. On 19 October 2000, a Notice of Ways and Means motion that included the proposed relief was concurred in by the House of Commons. Parliament was then dissolved. The government used existing legal mechanisms to authorize the issuing of cheques. An order-in-council was passed on 12 December 2000 and special warrants were issued in January 2001, allowing cheques to begin going out to recipients at the end of January.

The audit observation raises concerns with respect to parliamentary oversight and the targeting of the relief for heating expense measure.

On the first concern, the audit observation states that a delay of no more than six weeks would have allowed Parliament the opportunity to debate the measure before the spending took place, and without compromising the government's objectives. The passing of an order-in-council on 12 December 2000 allowed payments to be sent to recipients starting 31 January 2001. If the government instead had waited until the 29 January 2001 return of Parliament to introduce legislation, and even if the legislation had been passed almost immediately, relief payments would have been delayed until mid-March, at the earliest, beyond the peak heating season. Moreover, because the Canada Customs and Revenue Agency begins processing large volumes of individual tax returns in March, the delivery of heating relief could have been delayed further, possibly until July.

As to the second concern, the audit observation appears to conclude that the use of the GSTC mechanism resulted in poor targeting of the measure. However, this would interpret the government's objectives too narrowly, suggesting that the goal was to provide relief only to those low- and modest-income households facing immediate increases in heating costs from higher prices for fuel (for example, heating oil and natural gas). In fact, the objective was to target low- and modest-income Canadians who faced higher heating costs immediately as well as those who would face higher costs subsequently (for example, those affected indirectly through higher rents or utility costs). In these circumstances, it was proper to choose the GSTC as the delivery mechanism because it would deliver relief to the target population, and do so quickly and cost-efficiently.

The audit observation also notes anomalies in the delivery of heating relief. For example, relief was provided to 13,100 Canadian taxpayers who did not live in Canada, deceased people, and prisoners. However, it is important to note the following:

- These particular anomalies represent less than 0.2 percent of the total number of 8.6 million payments made.
- The relief provided to these groups was about $2 million. To change the GSTC system to eliminate these anomalies would have cost $50 million and delayed the delivery of the cheques until after the winter months.

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Parc Downsview Park Inc.

Parliamentary control of programs and spending

In brief

In October 2000, we reported that the Government of Canada had not requested—and accordingly Parliament had not provided—clear and explicit authority for the creation and operation of an urban park. Nor had Parliament authorized the related spending of public funds, estimated at more than $100 million.

In the current year, we noted that, while Parliament's authorization had still not been obtained, the Government of Canada had undertaken a significant transaction whose effect was an infusion of approximately $19 million in cash to Parc Downsview Park Inc. for its program activities.

Background

13.46 Parc Downsview Park Inc. (Downsview Park) was established following the closure of Canadian Forces Base Toronto. In April 1997, the government issued an order-in-council authorizing Canada Lands Company Limited (Canada Lands) to set up a subsidiary corporation to develop an urban park. Canada Lands incorporated Parc Downsview Park Inc. as a wholly owned subsidiary Crown corporation in July 1998, and Downsview Park began operations in April 1999.

13.47 As we noted in our October 2000 Report, the government met all of the applicable administrative and legal requirements in establishing Parc Downsview Park Inc. During 1999–2000, National Defence had paid $2 million to Downsview Park for expenditures related to the development of the Downsview Park site. In our view, these expenditures were not a valid charge against National Defence Vote 1, which Parliament had authorized to be used for the Department's operating expenditures.

13.48 Normally, when a new Crown corporation is established, it receives a mandate from Parliament through legislation establishing a parent Crown corporation. The government chose to set up Downsview Park as a subsidiary, which had the effect of leaving Parliament out of the decision-making process.

13.49 In our 2000 Report, we concluded that the government had not requested clear and explicit approval from Parliament for the creation and operation of this urban park. Furthermore, Parliament had not authorized the related spending. The total costs to develop this park are estimated at more than $100 million.

Issues

13.50 The government acquires land to meet its need to deliver a program. When the land is no longer needed for program purposes, it is declared surplus and is sold. The proceeds from the sale are returned to the Consolidated Revenue Fund (CRF). Parliament then votes on its program priorities and appropriates money for them from the CRF through the Estimates process. This process is intended to ensure that spending of public money is authorized by Parliament.

13.51 During 2000–01, Downsview Park undertook the following transactions:

- On 15 August 2000, pursuant to the authority granted under an order-in-council, Downsview Park acquired about 32 acres of land from National Defence in exchange for a $19 million promissory note, payable in 2050. The note bears no interest, is unsecured, and is subordinated to future indebtedness of Downsview Park.
- In September 2000, Downsview Park sold this piece of land to a private sector company and received a net consideration of $19.9 million. The proceeds were deposited in Downsview Park's bank account. No repayment was made to the Government of Canada, and the proceeds are intended to be used for the operations of Downsview Park.
- In its March 2001 financial statements, Downsview Park recorded the promissory note as equity of the Government of Canada, as the note bears no interest and is not repayable for 50 years.

13.52 Normally when the government transfers properties to Canada Lands for disposal, the corporation issues promissory notes payable to the government in consideration for the acquisition of real estate properties. The government receives payment on the promissory notes on whichever date is earlier, their maturity date (two months to eleven years) or the date on which net proceeds become available from the corporation's sale of the properties for which the notes were issued. The payments to the government are deposited in the CRF.

13.53 In this case, National Defence transferred the land to Downsview Park under the terms of the promissory note. This fact and the subsequent sale of the land by Downsview Park to a private sector company mean in effect that the government indirectly transferred $19 million in cash to Downsview Park to fund new program activities.

13.54 The government has informed us that these land transactions were undertaken in compliance with the law. Given the importance of this project and the nature of the transactions—an infusion of approximately $19 million in cash from the sale of a federal asset—we believe that formal approval by Parliament would have been preferable.

Conclusion

13.55 Although the government had still taken no steps in 2000–01 to obtain Parliament's authorization to set up the urban park, it entered into significant transactions for which, in our opinion, formal approval by Parliament would have been preferable. We believe there is a pressing need for the government to remedy the situation so that the role of Parliament is fully respected and Parc Downsview Park Inc. is able to carry out its mandate effectively.

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Appendix A *Auditor General Act*

R.S.C., c. A-17
An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting
1995, c. 43, s.1.

Short Title

Short title

1. This Act may be cited as the *Auditor General Act*. 1976–77, c. 34, s.1.

Interpretation

Definitions

2. In this Act,

"appropriate Minister"

"appropriate Minister" has the meaning assigned by section 2 of the *Financial Administration Act*;

"Auditor General"

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"category I department"

"category I department" means

(a) any department named in Schedule I to the *Financial Administration Act*,

(b) any department in respect of which a direction has been made under subsection 24(3), and

(c) any department, as defined in the *Financial Administration Act*, set out in the schedule;

"Commissioner"

"Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

"Crown corporation"

"Crown corporation" has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

"department"

"department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

"registrar"

"registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

"sustainable development"

"sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

"sustainable development strategy"

"sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development. 1976–77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

Auditor General of Canada

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him. 1976–77, c. 34, s. 4; 1980–81–82–83, c. 50, s. 23, c. 55, s. 1.

Duties

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976–77, c. 34, s. 5.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976–77, c. 34, s. 6; 1980–81–82–83, c. 170, s. 25.

Annual and additional reports to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency;

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

(f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976–77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976–77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976–77, c. 34, s. 9.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976–77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976–77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976–77, c. 34, s. 12.

Access to Information

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976–77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976–77, c. 34, s. 14.

Staff of the Auditor General

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976–77, c. 34, s. 15; 1992, c. 54, s. 79.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976–77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976–77, c. 34, s. 18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976–77, c. 34, s. 19.

Estimates

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976–77, c. 34, s. 20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976–77, c. 34, s. 21.

Audit of the Office of the Auditor General

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976–77, c. 34, s. 22.

Sustainable Development

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

(a) the integration of the environment and the economy;
(b) protecting the health of Canadians;
(c) protecting ecosystems;
(d) meeting international obligations;
(e) promoting equity;
(f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
(g) preventing pollution; and
(h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond

(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or

(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more that one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and

(b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;

(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and

(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.

Strategies to be tabled

24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons

(a) within two years after this subsection comes into force; or

(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council

(4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

Appendix B *Financial Administration Act*

R.S., c. F-11
Extracts from Part X

CROWN CORPORATIONS
Financial Management

Books and systems

131. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s.42.

Errors and omissions

133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor

134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible

135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(2) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if that person or any of his business partners

- (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,
- (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or
- (iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved

136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

Report

139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(2) The report of an examiner under subsection (1) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

Special report of appropriate Minister

140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

Special report to Parliament

141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

Examiner

142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information

144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 131,

(b) the annual auditor's report referred to in subsection 132(1),

(c) a statement on the extent to which the corporation has met its objectives for the financial year,

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c.31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

Appendix C Reports of the Standing Committee on Public Accounts to the House of Commons, 2000–01

The following reports are available on the Web site of Canada's Parliament (www.parl.gc.ca).

36th Parliament, 2nd Session

Report 15—Chapter 6, Canada Customs and Revenue Agency and Department of Finance—Handling Tax Credits Claims for Scientific Research and Experimental Development, of the April 2000 Report of the Auditor General of Canada. Tabled 5 October 2000.

Report 16— Chapter 3, Citizenship and Immigration Canada—The Economic Component of the Canadian Immigration Program, of the April 2000 Report of the Auditor General of Canada. Tabled 5 October 2000.

Report 17—Chapter 7, Royal Canadian Mounted Police—Services for Canada's Law Enforcement Community, of the April 2000 Report of the Auditor General of Canada. Tabled 5 October 2000.

37th Parliament, 1st Session

Report 1—Reports presented during the 2nd Session of the 36th Parliament. Tabled 14 March 2001 and adopted 14 March 2001.

Report 2—International Financial Reporting Guidelines and Standards for the Public Sector. Tabled 29 March 2001.

Report 3—Vote 20 under Finance in the *Main Estimates* for the fiscal year ending 31 March 2002. Tabled 10 May 2001.

Report 4—*Public Accounts of Canada* 1999–2000. Tabled 10 May 2001.

Report 5—Chapter 11, Human Resources Development Canada—Grants and Contributions, of the October 2000 Report of the Auditor General of Canada. Tabled 17 May 2001.

Report 6—Chapter 14, Canadian International Development Agency—Managing Contracts and Contribution Agreements, of the October 2000 Report of the Auditor General of Canada. Tabled 17 May 2001.

Report 7—Government of Canada's new policies on internal audit and evaluation. Tabled 6 June 2001.

Report 8—The Committee's Report on the performance and plans and priorities of the Office of the Auditor General of Canada. Tabled 6 June 2001.

Appendix D Report on the audit of the President of the Treasury Board's report to Parliament

Tablings in Parliament for parent Crown corporations: Annual reports and summaries of corporate plans and budgets

The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets, and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period, and the time they were actually tabled. The report on tablings is the responsibility of the President of the Treasury Board and is included in her annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December (not tabled for 2001 at time of going to press).

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 2001. Further, I am required to report on this audit in my annual Report to the House of Commons.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining, on a test basis, the systems and procedures used by the Treasury Board Secretariat to monitor the tabling of the summaries and annual reports in each House of Parliament, and the information contained in the report. Accordingly, it included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, the information contained in the report on tablings is accurate in all significant respects in accordance with the description of the Deadlines for Tabling in Parliament disclosed in the report.

The following paragraphs are intended to highlight certain information that I believe may be of interest to members of the House of Commons and that are not highlighted or disclosed in the report on tablings in its current format.

This year's report on tablings identifies 103 instances of documents that were tabled late. This represents an increase of 25 in the number of late tablings from previous years. Sixty-eight of these instances relate to documents that were to be tabled this year and the remaining 35 were to be tabled in prior years. We have encouraged the Treasury Board Secretariat to investigate the reasons for this increase, and the Secretariat has informed us that it will follow up with the appropriate ministers regarding this matter.

The report does not disclose that, in three instances, the corporate plans for the year starting 31 January 2001 or before were not approved by the Governor in Council as at 31 July 2001. In addition, in 23 instances, corporate plans were only approved after the beginning of the period covered by the plans. In 13 of those instances, plans were approved more than two months after the beginning of the period covered.

R. Flageole

Richard Flageole, FCA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
31 October 2001

Appendix E Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (Exhibit E.1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 2001, the full cost of the annual audit report was $1,223,181.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that

- assets have been safeguarded and controlled;
- financial, human, and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 2000–01 the Office completed the special examination of four Crown corporations. The costs were

Canada Lands Company Limited	$346,488
Canadian Dairy Commission	$408,785
Canadian Museum of Civilization	$518,175
Laurentian Pilotage Authority	$251,529

Exhibit E.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2001

Atlantic Pilotage Authority	31.12.00	$ 78,901
Atomic Energy of Canada Limited (joint auditor)	31.03.01	279,432
Business Development Bank of Canada (joint auditor)	31.03.01	353,322
Canada Deposit Insurance Corporation	31.03.01	90,769
Canada Development Investment Corporation (joint auditor)	31.12.00	46,860
Canada Lands Company Limited (joint auditor)	31.03.01	217,118
Canada Mortgage and Housing Corporation (joint auditor)	31.12.00	275,412
Canadian Commercial Corporation	31.03.01	106,570
Canadian Dairy Commission	31.07.00	124,624
Canadian Museum of Civilization	31.03.01	88,829
Canadian Museum of Nature	31.03.01	86,183
Cape Breton Development Corporation	31.03.01	252,130
Defence Construction (1951) Limited	31.03.01	54,761
Enterprise Cape Breton Corporation	31.03.01	105,530
Export Development Corporation	31.12.00	453,237
Farm Credit Corporation	31.03.01	353,493
Federal Bridges Corporation Ltd.	31.03.01	50,525
Freshwater Fish Marketing Corporation	30.04.00	71,807
Great Lakes Pilotage Authority, Ltd.	31.12.00	51,162
Laurentian Pilotage Authority	31.12.00	64,270
Marine Atlantic Inc.	31.12.00	229,489
National Capital Commission	31.03.01	228,955
National Gallery of Canada	31.03.01	107,657
National Museum of Science and Technology	31.03.01	83,593
Old Port of Montreal Corporation Inc.	31.03.01	140,334
Pacific Pilotage Authority	31.12.00	48,033
Petro-Canada Limited	31.12.00	14,219
Queens Quay West Land Corporation	31.03.01	36,513
Royal Canadian Mint	31.12.00	321,950
Seaway International Bridge Corporation Ltd.	31.12.00	44,861
The Jacques Cartier and Champlain Bridges Incorporated	31.03.01	72,018
Standards Council of Canada	31.03.01	44,685
VIA Rail Canada Inc. (joint auditor)	31.12.00	229,743

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